Canadian Trade Policy for the 1980s

A DISCUSSION PAPER

EXTERNAL AFFAIRS

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Preface

In recent years much attention has been paid to the increasing interdependence of the world in which we find ourselves. As a trading nation, Canada depends heavily on its international trade performance for general economic well-being. It is the most direct way in which foreign affairs touch our daily lives. We may drink Florida orange juice for breakfast, check the time on our Swiss watch, wear a shirt from Hong Kong, buy French perfume and watch an American movie on a Japanese TV. At the same time, we realize British and American newspapers are printed on Canadian paper, New Yorkers ride on a Canadian-made subway car, other Americans heat their homes with Canadian gas, the Chinese make their noodles with Canadian wheat and Venezuelans drive Canadian-made cars. While many worry about the negative impact of imports on potential employment, we should not lose sight of the fact that exports have traditionally been one of the main engines of growth and job creation in the Canadian economy. In today's interdependent world, we need to do both.

International trade is largely conducted by the private sector but the Federal Government plays an important role in providing a framework of laws, regulations, programmes and policies which help to ensure that Canadian producers and traders are not placed at a disadvantage compared to their foreign competitors. The key to a successful trade performance in a much tougher world economic environment will be improved productivity and competitiveness. While the signs indicating economic recovery are positive, we cannot afford to become complacent. All Canadians will thus need to co-operate and contribute to achieve continued prosperity through trade.

Over the past two years, the Government has conducted a detailed review of its trade policies and programmes in an effort to ensure that they reflect the problems and priorities of the 1980s. This Discussion Paper formed an integral part of that review. Together with the detailed *Review of Canadian Trade Policy*, it formed the analytical, factual and conceptual basis for Cabinet's consideration of a trade policy framework for the 1980s. It is now being made available to a wider audience. As such its purpose is to contribute to constructive consideration and discussion of the implementation of the trade policy framework the Government will pursue in the 1980s. It is the Government's view that such discussion, not only by experts, but by the public at large, can only serve to strengthen Canada's trade performance and the interests of all Canadians.

The framework for the conduct of Canada's trade policy contained in these pages does not provide for quick and easy solutions to the difficult choices we often face. It does not address particular problems and immediate needs. Rather, this document sets out the basic principles which have animated and will continue to ani-

mate the pursuit of Canada's trade objectives. What is important is that we all realize that these basic principles, central to which is an open, multilateral trading system, continue to be the best option available to enable Canadian consumers and producers to benefit from Canada's abundant natural resources and to improve their standard of living. This document determines the tone and the context for more precise decisions taken on a day-to-day basis.

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and Secretary of State for
External Affairs

Gerald A. Regan

Minister of State for
International Trade

OTTAWA, August, 1983

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Purpose and Introduction: Preparing for the Twenty-first Century

The purpose of this paper is to examine the importance of trade to Canada's economic development and to seek to establish a consensus on basic principles to guide Canadian trade policy in the decades ahead. It analyzes the domestic and international environment in which trade is conducted, the policy instruments and considerations which affect Canada's trade performance, and the factors at play in the Canadian and world economies which would argue for a change in emphasis or direction for future trade policy. It demonstrates the close links between domestic and trade policy objectives and ways and means to strengthen our international competitiveness. The paper offers views and broad conclusions and indicates where priorities and emphases are needed based on domestic, sectoral and regional considerations, on the interplay of domestic, foreign and trade policies, on the management of international trade relations, and on the issues which are likely to confront future trade negotiations. It attempts to establish a clear, coherent framework to enable Canada and Canadians to respond to the challenges and opportunities in the trade field during the decades ahead.

The broad objectives of Canadian trade policy can be briefly summarized as follows:

- The development of a stronger, more efficient, productive, competitive, growing and non-inflationary domestic economy, the increased per capita wealth of which is shared by Canadians from all regions of the country; and

- The promotion of a more stable and open international trading environment within which competitive Canadian and foreign firms alike are encouraged to plan, invest and grow with confidence.

Beyond these basic objectives, however, trade policy is about day-to-day decisions affecting the tariff on a single product, a quota which can make or break an industry, a countervailing duty which will determine profits for years to come, and the availability of government-guaranteed export credits; it is about complex relationships between unequal trading partners within a carefully structured and balanced set of rules; and it is about the inter-relationship between economic policy and trade performance. Meeting these day-to-day challenges requires a thorough knowledge of what has gone before and a full appreciation of what may or may not work. To a large extent Canadian trade policy has been, and will continue to be, developed as a trade-off between the objective of improved access to foreign markets, the need to promote efficiency and competitiveness, and the need to provide protection for those Canadian industries subject to intense competitive pressures but considered important in terms of national or regional interests. Decisions on the use of particular policy instruments essentially revolve around these three factors.

Within this context, more *specific export trade policy objectives* are:

- continuing to exploit the adjacent US market, while reducing the tendency towards the development of regional groupings, through *reductions of trade barriers on a non-discriminatory* basis;
- advancing Canadian industrial development through expanding Canadian export opportunities for *further processed food and industrial materials* (the upgrading policy and sector approach) and *high-technology goods* and *other manufactures* where Canada has or could develop special advantage, e.g., transportation, telecommunications equipment and certain types of machinery; and
- promoting long-term and stable markets for Canada's primary exports (agricultural, fisheries and industrial) on an internationally competitive basis including, where appropriate, through *international commodity arrangements*.

On the *import side*, Canadian trade policy objectives are to provide an international framework which will facilitate the development of a competitive domestic economy, while at the same time meeting the basic requirements for a viable agricultural and industrial base in the Canadian economy. Specific import policy objectives include:

- an appropriate level of regular *protection* designed to balance the legitimate interests of Canadian producers and manufacturers, users and consumers;
- measures to protect Canadian producers against *injurious import competition* arising from such practices as export subsidies, dumping and price depression;
- adequate scope to take temporary border measures against short-term injurious competition in support of domestic measures to deal with *structural problems* in particularly sensitive sectors in the Canadian economy, e.g., textiles and clothing, footwear; and
- reasonable measures to *safeguard Canadian agricultural producers* from special problems which arise out of instability in trade in agricultural products.

Taking the *export and import side together,* Canadian trade objectives seek to achieve a balanced development of trading opportunities which take into account *regional and sectoral interests.* Furthermore, Canada, as an important trading country smaller than some major trading countries, has an interest in an effective international framework responsive to the changing needs of the world economy and which makes adequate provision for consultation, international surveillance and dispute settlement.

Trade policy is, of course, only one of a range of policies, instruments and programmes at the federal government's disposal to stimulate the development of a competitive and productive economy and the deployment of all of these has done much to influence the characteristics of the Canadian economy. Canada faces formidable challenges for the rest of the decade, challenges which also exist for most of our trading partners. While economic growth in the coming decades will not be a zero-sum game, changed circumstances strongly suggest that not all nations will ben-

efit, or benefit equally. The ability to take advantage of that growth will, to a large extent, depend on the economic climate fostered by government policies and on the willingness of the private sector aggressively to pursue opportunities and overcome obstacles. It will also depend greatly on the quality of day-to-day decisions.

The prolonged recession, with record levels of unemployment and persistently high rates of inflation that plagued most industrialized and developing countries created severe strain on the world trading system. Conventional wisdom about the benefits of freer trade was being questioned. Protectionist pressures mounted as did tensions between and among major trading countries. These circumstances are particularly acute for Canada given our heavy dependence on trade with one country—the USA—the slow growth anticipated throughout the 1980s for the US market, and the concentration of our exports in a relatively narrow range of resource-based products. Our competitiveness is slipping compared to our major trading partners and we are not as well-positioned as our competitors to export manufactured goods—the area of greatest anticipated growth in the 1980s. That is the nature of the challenge.

The analysis and conclusions which follow are based on a comprehensive review of Canadian trade policies and reflect an extensive round of consultations with provincial governments, business and labour leaders, bankers and other interested Canadians based on the Background Paper, *A Review of Canadian Trade Policy*. Those consulted were supportive of the government's effort to develop a comprehensive trade policy and constructive in their contributions. As a result, this paper reflects many of the priorities and sensitivities of provincial and private sector representatives. Above all, the consultations revealed the importance of trade and particularly exports for Canada's well-being as well as a strong desire for a firm national consensus on the policies which affect Canada's trade relations and on the domestic environment which can best complement a successful trade performance. The private sector also stressed that it is the business of government to provide a framework and environment within which the private sector can best pursue its economic goals, while it is the business of the private sector to grasp opportunities as they become clear, with appropriate help from government where necessary.

There are clear limits to what can be achieved through the vehicles of trade policy, trade promotion and trade relations. This paper indicates where some of the constraints and opportunities lie: in the realms of fiscal and monetary policy, competition policy, in investment and industrial policy etc., but stops short of presenting precise solutions. That would require further work beyond the direct scope of trade policy. For the purpose of this paper, it is sufficient to identify the problems and point at the direction of solutions for those issues that are beyond trade policy.

I. **The Economic Environment:** A Tougher World

The industrialized world, including Canada, entered the 1980s in the midst of its second experience of "stagflation" in the last ten years, without ever having fully resolved its first experience. Governments in most of the major OECD nations are currently committed to the reduction of inflation as their primary medium-term goal, and are pursuing policies designed to restrict demand pressures and establish

better competitive positions in world markets. Thus it appears likely that the 1980s will be a decade of relatively slow growth in Canada's traditional major export markets, and increasing competition for these markets.

The structure of the world economy is undergoing rapid transformation. There has been a pronounced shift in industrial power away from the USA and towards Japan, Europe and the Newly-Industrialized Countries (the NICs). Despite the recent slump in world oil markets there has been a dramatic shift in wealth, hence purchasing power, to the major oil-exporting countries. Standard technologies are being transferred at a record pace to low-cost-labour developing countries which are increasingly better able to absorb new techniques. New technologies also require faster domestic restructuring and strain the adaptive abilities of industry in the developed countries. In short, the race to sustain competitiveness has accelerated as the growth of the world economy has diminished, and this is likely to be an endemic feature of the 1980s.

The value of world trade in 1980 reached some $2,000 billion US, a six-fold increase in real terms since 1950. While world trade grew steadiliy following the founding of the GATT, most spectacularly during the 1960s, there has been a marked slowdown and even regression in the past two or three years attributable to recessionary conditions, and this has placed serious strains on the trade and payments system. For the first time since the GATT was established in 1947, there was no real growth in world trade in 1981, underlining the need to bring the situation under control. The situation was repeated in 1982.

Canada's share of total world trade has steadily declined over the post-war years, although not as dramatically as that of the United States. There was a brief turnaround in the late 1960s. Canada's share in 1968 stood at 5.2 percent compared to 3.6 percent in 1981. This has been cause for alarm on the part of some commentators. While there is cause for some alarm due to declining competitiveness, this should be tempered by the realization that much of the change was caused by the increased participation of other nations, starting with Europe and Japan following their post-war reconstruction, and more recently the developing countries, particularly the newly industrialized and OPEC countries. A further consideration is that because this data is usually presented in terms of US dollars, changes in the relative values of various currencies can have a profound impact on relative shares of world trade. Finally, the increased value of oil has distorted comparisons with the period before 1973. Despite frequent swings and large movements in individual prices, Canada's terms of trade (the price of exports relative to imports) are virtually identical to the level of 30 years ago.

The immediate economic prospects now offer some room for optimism, but in a period of prolonged recession with record levels of inflation and unemployment, it was not surprising that we saw increasing pressure for protectionism, for narrow versions of reciprocity and generally for a system which yields benefits with minimal cost to the beneficiary. Uncertainties associated with the energy situation, factors inhibiting investment and a period of continuing inflation suggest that, at best, we can look forward to relatively modest growth in international trade. Furthermore, the impact of the new technological revolution on industrial and trade structures will

put further pressure on the labour market and on import regimes at the same time as it creates new opportunities for new markets and for offsetting labour-cost disadvantages in traditional labour-intensive industries. As in the past, periods of major challenge to the status quo in the international trading order will also offer opportunities to move further ahead with action on trade policy.

Financial markets have in the past few years experienced unusual volatility and there are serious questions about the adequacy of present arrangements (and institutions) to cope with the situation. The debt load facing many developing countries, and some in Eastern Europe as well, is such that some problem countries may be forced into rapid adjustment policies which could create serious social unrest at home and severely reduce imports from industrial countries. Although Canada trades less with these countries than do most other industrialized countries, we cannot be shielded from the overall effect of an international liquidity squeeze and the consequential pressure on the trading system as a whole.

Against this background of slow international market growth, financial instability, and increased international competitiveness, it will be crucial that Canada also control and reduce the rate of growth of costs and prices in the economy in the 1980s and promote productivity growth. We will need to be alert to defend Canadian interests, and to sustain and improve access in a period of increasing protectionism. To neglect to do so would ultimately result in reduced output and employment growth, as Canadian exports are priced out of foreign markets and foreign products displace Canadian goods at home. At an aggregate level, the government remains committed to a medium-term strategy of monetary and fiscal restraint designed to reduce demand pressures in the form of wage and price increases.

Demand management policies can reduce price and cost pressures in the economy. However, these demand-oriented measures need ultimately to be supported by improvements in the supply performance of the economy, in particular by gains in terms of factor productivity. The 1970s were characterized by a sharp slowing in the rate of productivity growth which exacerbated the inflationary pressures of sharp commodity price increases, most notably oil price increases. A recovery of productivity growth during the 1980s would serve to assist in reducing inflationary pressures and to improve Canada's international competitiveness. As well, a strong productivity performance could make the economy less vulnerable to the inflationary effects of external price shocks of the type experienced in the 1970s.

While there is no simple explanation of the cause of either Canada's or the world's present economic situation, it is generally accepted that weakness in investment has been a key element which, in turn, reflected a lack of predictability and confidence about the future, especially in respect of inflation, and interest rates. Developments in international economic relations and financial markets added to the uncertainties. In this situation, short-term investments are preferred by investors. Yet, it is the longer term, more costly and more risky ventures which normally yield the greatest return in productivity growth and international competitiveness. It is these investments which ensure that adjustment in an economy results in the expansion of efficient industries and allows for the contraction of those which are adversely affected by technological change, shifts in demand or changes in comparative advan-

tage. While our economy has been seriously affected by developments in the world economy, its fundamental strengths remain in the form of resource wealth, skilled manpower, and our high level of technological capability. Nonetheless, we must not let our competitive position slip. Recent measures taken by the government to contain inflation, particularly the 6 percent/5 percent programme, were put in place to help ensure that Canada is not priced out of foreign markets which could have major adverse effects in terms of jobs and economic growth. They represent a start in the right direction.

Economic Development for Canada in the 1980s identified a number of opportunities for attention during the present decade and set out a programme through which the government would assist and encourage business and labour to exploit these opportunities. Clearly the recession imposed constraints on Canada's ability to proceed apace with new development proposals, particularly in the resource sector, and suggested a shift in emphasis toward the maintenance and enhancement of a positive climate for private sector investments. Further, the fiscal capacity of the government to support economic development is now more limited and available funds will need to be deployed in the most effective manner, consistent with development and regional priorities, to improve productivity and long-term international competitiveness in the Canadian economy, and to ensure that Canada emerges from current conditions with the sustained capacity to compete in world markets. While the short-term pressure is on funds for job creation, unemployment insurance, and welfare, the long-term need remains for sustained economic development.

Conclusions:

- The world economy is emerging from a period of severe strain, and there is little likelihood of a return to prolonged rapid growth. Demand is low and capacity is underutilized. Technological changes are occurring more rapidly and frequently creating uncertainty. Industrial power relationships are shifting and pressures for both protection and subsidies remain. These conditions pose a major challenge for Canada, specifically to sustain international competitiveness, to maintain and expand existing export markets and to attract investment beneficial to Canada's economic development.
- World financial markets are experiencing unusual volatility and the mounting debt burden of developing and state-trading countries is straining the capacity of international institutions and industrialized country governments to maintain equilibrium.
- While economic prospects are certainly not buoyant, there are nonetheless real and achievable opportunities for growth through trade if all sectors of the Canadian economy pull together to ensure that we are well-positioned to seize opportunities in foreign markets as economic recovery occurs.

II. **International Trade in the Canadian Economy:** Creating Jobs Through Exports

Historically, Canada has been a trading nation, exporting a quarter or more of its output of goods and services to other countries in exchange for their products, capital, and information. This is not a surprising feature of the Canadian economy,

given its rich supply of raw resources, but relatively small population base, and its geographical characteristics. Over time it has proven more efficient to exploit Canada's natural resource base in order to gain access to goods and services which could not be produced economically — or physically — in Canada. Trade has thus permitted Canadians to enjoy a higher standard of living than could have been achieved by closing our borders. Whether or not exports will constitute as large a proportion of Canadian output in the 1980s as they have historically, or imports as large a share of domestic purchases, it seems clear that foreign trade will remain a fundamental element of Canada's economy in the 1980s. Canada's population will remain too small, and its industrial productive capacity too specialized, to permit a significant reduction in foreign trading activity without severely reducing the Canadian standard of living i.e., access to a broad range of goods, services and technologies at reasonable cost.

Trade is, of course, not an end itself. Rather, we trade because it has proven an efficient means to increase wealth through the international division of labour. If the nature of world trade has changed, it is because the international division of labour has changed. There are more players; there is an infinitely greater variety of products in search of markets; there is, above all, the surge of technology which has led to very much greater and more rapid changes in comparative advantage than once characterized the world trading environment. These factors have accelerated a process of particular interest to Canada: the international *subdivision* of labour. Both countries and companies no longer compete for a market, but for segments of a market. The growth in the production of parts and components for final assembly elsewhere is a further illustration of this phenomenon. No country or company can keep up efficiently with all the potential developments in a sector—thus opening up scope for greatly increased cooperation between and among former competitors, at national and international levels, within and among various industrial sectors. Herein lie some of the most exciting opportunities for Canadian industry in the 1980s.

A strong trade performance has always been central to Canada's economic policies. Ensuring international competitiveness of Canadian resource, manufacturing and service industries and promoting a more productive and efficient allocation of resources have been fundamental considerations underlying these policies. Access to investment, technology and knowledge and the enhancement of their benefits to Canada and its regions, have been constant concerns of Canadian industrial policies. From the early days of Confederation, the various regions of Canada have looked abroad for markets for a large proportion of the output of their resource-based industries: agriculture, fisheries, forest products, metals and minerals. Much of the large infrastructure investment has been directed to the development of the necessary transportation systems and port and handling facilities, particularly in Atlantic Canada, Quebec and Western Canada, to move these resource products to world markets. Today, more than half of farm income is derived from exports and more than half of the output of the mining and forestry sectors is destined for foreign markets.

Similarly, in order to obtain the necessary economies of scale, the strong and technologically advanced manufacturing sectors in Ontario and Quebec dedicate a large portion of their output to exports. Half of the output of the manufacturing sec-

tor is exported. More traditional manufacturing such as textiles, clothing and footwear, and a range of other standard-technology products concentrated in Quebec and Ontario have had difficulty meeting increased international competition in the domestic market and have been under pressure to adjust into more internationally competitive areas. The complexity of the influences at play in the international market-place today, together with the rapidity of change which is taking place, is resulting in almost continuous change in comparative advantage as between both products and countries. In this dynamic environment, Canada, like other countries, must be prepared to adjust and adapt its productive facilities to changing economic conditions, both at home and abroad, if improvements in real incomes and economic welfare are to result.

Food and crude materials now account for about 30 percent, and partially or fully manufactured products for some 70 percent, of Canadian merchandise exports, compared to some 40 and 60 percent respectively in the early 1960s, indicating a real growth in the level of processing of Canadian exports. A comparison of the composition of Canadian exports in constant dollars demonstrates even more dramatically the increased level of processing of Canadian exports. A recent Conference Board Study, for example, suggests that in 1971 dollars, end-products constituted 45.6 percent of Canadian exports in 1981 and together with semi-processed products, made up 78.2 percent, while raw materials made up only 21.8 percent. Our comparative advantage, however, remains in resource-based products. Throughout the past decade, fully 60 percent of our exports were directly identifiable as resource-based at various stages of processing. There has also been a considerable diversification of the composition of further processed Canadian exports in the last two decades. Indeed, the expansion of Canadian exports in the last 15 years was largely the result of a real growth in exports of manufactured goods. It is estimated that in 1981 some 600,000 workers (or, over one-third) in Canadian manufacturing alone were *directly* employed in output destined for international markets. Further employment is, of course, generated by export-related service industries and resource exports, as well as by industries providing input into goods processed further in Canada before export. The export orientation of total manufacturing rose from 19 percent in 1966 to 31 percent in 1980; in some major sectors such as aircraft, urban transportation, machinery, primary metals, paper and allied industries, automotive and electronics, this proportion was higher than 50 percent. For most industries this greater degree of integration into world markets has been based on a significant rationalization and specialization which in turn has led to greater productivity and competitiveness. Thus international trade has allowed Canadian industry to achieve economies of scale which were not attainable by serving the domestic market alone.

Imports of machinery and equipment have historically allowed Canadians access to a range of goods not produced either competitively or in sufficient quantities to meet the needs of various industrial users. These imports play an important role in the development of an efficient industrial structure. Consumers have also benefited from access to a wider range of consumer goods and essential commodities such as tropical foodstuffs. Similarly, access to foreign technology, knowledge and investment has been instrumental in achieving a high standard of living and a diversified economic structure. In the last 15 years, imports of manufactured products have grown commensurately with similar exports, and the degree of import penetra-

tion has increased from 21 to 32 percent. Although there has been a traditional deficit in Canadian trade in manufactured products, particularly of end products, the implicit self-sufficiency ratio has hardly changed in the last 15 years. This also reflects a considerably higher degree of participation in international trade by Canadian manufacturing industries and a marked movement by Canadian industry towards international specialization, with the export-oriented industries gradually strengthening their position.

Canada is a nation which defies geography. Throughout our history, therefore, the federal government has fostered policies aimed at knitting the country together. Trade policy is no exception. From Sir John A. Macdonald's National Policy to today we have striven to maintain a policy which reflects the interests of the various regions, while remaining national in scope. Fish, for example, constitute less than two percent of our exports—but figure prominently in the economies of individual provinces and are featured prominently among national trade policy objectives. Similar priority is attached for identical reasons to developments affecting trade in agriculture, forest and mineral products. The Autopact was established to provide a stronger footing for a major manufacturing sector in central Canada. Furthermore, the commitments made in bilateral and multilateral trade agreements often provide the basis for coordinating domestic economic policies which would otherwise be pulled to and fro by special interests—thus maintaining consistency of purpose applicable to the country as a whole. A gradual movement towards freer trade has been a consistent policy orientation of successive governments and has proven to be an effective integrating vehicle for Canadian society. A continuing, strong trade performance will not only help sustain economic growth but also can serve to strengthen the economic development potential of different regions and industrial structures across the country.

A strong trade performance also plays a vital role in balancing the external accounts. Overall, Canada has traditionally registered a substantial trade surplus which has helped to pay for interest and dividends on foreign investment, for access to foreign technologies, for the deficit in tourism and for borrowings by different levels of government to finance economic development in Canada.

Trade is thus the vital link between the Canadian economy and the international competitive environment. It is through the medium of trade that Canadian producers have become integrated into world markets. Furthermore, trade has played and should continue to play a major role in providing an improved standard of living for all Canadians. Improved quality of employment and more rewarding jobs can only be achieved through continued growth in production which is integrated into world markets. Indeed, for Canada, trade has been and will continue to be the engine for growth. We do not have the option of a consumer-led recovery available to us.

Conclusions:

- Canada is crucially dependent on trade to maintain the current standard of living. This single fact emphasizes the significance of trade objectives in the

formulation of Canada's foreign and domestic economic development policies. Today, almost one-third of every pay-cheque in Canada is paid for by exports.

- A gradual movement towards freer trade has been a consistent policy orientation of successive governments in the post-war years. All sectors and all regions in Canada depend heavily on exports to foreign markets, and both producers and consumers rely substantially on imports of a wide range of goods and services. The stronger industrial sectors tend to be heavily export-oriented. This outward-looking policy has contributed importantly to fostering an open Canadian society and strengthening Canadian unity. A continuingly strong trade performance (based on steadfast support for and participation in an open, multilateral trading system) will help sustain economic growth, develop the economic development potential of different regions and strengthen industrial structures across the country.

III. Trade and Economic Policy

a) *The Race to Sustain Competitiveness*

Trade, both exports and imports, thus will continue to be one of the main driving forces in the Canadian economy. However, trade and trade policy cannot be treated in isolation. What happens in the external sector is affected by the whole range of domestic policies, both federal and provincial, including fiscal and monetary policy, regional development policy, foreign investment policy, environmental controls, human resource policy, etc. It is the amalgam of these economic policies that provides the economic framework within which Canadian industry must seek out and develop markets both at home and abroad.

Border measures are probably the most visible aspect of policies affecting trade performance. A highly protected domestic market, whether achieved through border measures or subsidy programmes, will limit the incentive for Canadian firms to undertake the investments needed for them to compete in international markets. While there are situations in which the process of adjustment must reflect a balance between the need for greater efficiency and for equity in terms of those directly affected (requiring temporary, justified measures), Canadian producers are also Canadian exporters and they will only be successful exporters to the extent that they are not held immune from the burdens of adjustment and international competition. Beyond temporary safeguards, protectionism can thus prevent the reallocation of labour and capital from less productive to more productive activities and constrain the growth of the latter. Ultimately, the cost of protectionism is borne by consumers and more efficient producers in the Canadian economy. The regional distribution of these costs is often a further problem in Canada, since producers and consumers are not typically located in the same regions of the country.

Recent comparative studies of international competitiveness and productivity growth do not cast a favourable light on Canada. OECD studies indicate that our productivity growth since the mid-1970s has lagged behind that of our major competitors. The influential European Management Forum annually publishes a compre-

hensive report on industrial competitiveness based on some 240 subjective and objective criteria. The EMF defines competitiveness as

> . . . a measure of the immediate and future ability of industrialists to design, produce and market goods whose price and non-price qualities form a more attractive package than those in competitors abroad or in domestic markets.

Canada placed sixth in 1982 after Japan, Switzerland, the USA, Germany and the Netherlands. We used to be second to the USA.

There are, of course many ways to measure international competitiveness. In one sense, in a period of floating exchange rates, fluctuations in exchange rates act as an equilibrating element making many measurements ambiguous. A lower Canadian dollar, for example, may make exports cheaper but also increases the relative cost of imported inputs. In a fundamental sense, however, when productivity growth in one country lags significantly behind that of its major trading partners, its international competitiveness will deteriorate, especially when this phenomenon is coupled with wage increases which far outstrip productivity growth. Canada's competitive position deteriorated during the first half of the 1970s mainly due to higher Canadian wage and price increases relative to those in the United States. An improvement took place in the second half of the decade largely due to a significant decline in the external value of the Canadian dollar. There was, however, no reversal in wage increases and productivity growth. Indeed, in 1981-82 there was further pressure on the dollar resulting from wage increases and inflation rates significantly higher than those in the USA. An improvement in Canada's international competitiveness is thus of paramount importance.

The relative level of taxation between Canada and its main international competitors may place us at a disadvantage; exchange rate changes due primarily to capital flows may, at least in the short-term, adversely affect our export performance; actions taken by foreign governments in response to policy measures in Canada may affect our access to these markets; subsidy programmes which may seem appropriate for the short-term may hinder our longer-term opportunities in foreign markets. These examples are given merely to illustrate the inter-relationships involved. While it is not suggested that policy decisions taken in other areas should respond solely to trade considerations, trade is so vital to the welfare of the Canadian economy, that the implications for trade and international economic relations of such policies should be clearly understood before arriving at final decisions.

Canada faces particular problems in achieving international competitiveness, stemming in part from geography, climate and population dispersal. The negative impact of the relatively small domestic market is exacerbated by the fact that the market is relatively more fragmented and compartmentalized than our competitors. Nonetheless, Canada's strengths (resources, skilled manpower, energy, water, secure source of supply, etc.) have overcome these natural difficulties in the past and will continue to do so in the future provided government policies are supportive of the goal of improving the standard of living of Canadians through, for example, increased specialization and export development. It is basic that the trend which has seen labour costs rising more sharply than productivity be reversed. The road to a

return to productivity growth and thus international competitiveness may be rocky and uncomfortable—but it is essential that Canada get on it. It must, to succeed, be travelled by labour, business, and all levels of government. Canada must also become a truly common market. Finally, it is important to keep in mind that international competitiveness should not be measured only in terms of costs and prices. Other factors such as quality, delivery, and security of supply may be more important in any particular export project. Costs and prices are, however, basic and can be affected directly by a host of governmental policies.

b) *Macro-Economic Policies: Creating the Right Environment*

Promoting the efficient allocation of Canadian resources (including human and financial) and strengthening the international competitiveness of Canadian industry will require that domestic economic policy instruments (fiscal. monetary, investment, regulatory, etc.) reinforce and support the use of trade policy instruments (tariffs, contingency protection, export credits, etc.). Basic to this is the judicious use of macro-economic policies to create an environment within which the private sector can plan and invest with confidence.

Monetary Policy directly affects Canada's competitive position, although differently for various sectors of the economy and for competitive relationships with individual trading partners. The basic thrust of Canada's current monetary policy is to bring down inflation. While the pursuit of this policy may result in some short-term dislocation, its long-term effect should enhance Canada's international competitive position. It is by promoting a return to overall price stability that monetary policy has the greatest chance of supporting, in a sustainable way, Canada's trade performance. An inflation rate in Canada significantly higher than that being experienced by our major trading partners, particularly the USA, will manifest itself in the gradual deterioration of our competitive position and in the terms of trade, particularly for fully manufactured products.

The floating Canadian dollar plays a key role in promoting adjustment in our balance of international payments as economic circumstances change. The general level of the dollar reflects underlying economic forces: Canada's saving and investment position relative to other countries, price, cost and interest rate developments here and abroad, and the international pattern of demand and supply for commodities which figure prominently in Canadian trade.

Canada's *exchange rate policy* has been to allow the exchange rate to respond to changes in these underlying forces and there has been no attempt to achieve or maintain a particular external value for the Canadian dollar. Official interventions in the foreign exchange market by the authorities are confined to the promotion of orderly trading conditions. While monetary policy has focussed on the state of the foreign exchange market from time to time, this has been in response to short-term financial pressures originating abroad, has not run counter to fundamental balance of payments pressures, and has been supportive of the government's efforts to reduce inflation. The balance of evidence strongly suggests that an exchange rate which is imposed, either by direct intervention or indirectly through the use of monetary

policy, rather than flowing from the balance of payments itself, is unlikely to permanently affect trade flows or achieve commercial policy objectives.

High real *interest rates* represent a major obstacle to new investment necessary to sustain long-term competitiveness. The weak pace of world economic activity over the past three years was attributable, in some measure, to the height of interest rates and the resulting economic slowdown placed strains on the international trading system and encouraged protectionist pressures. High interest rates are in part an offshoot of the existing non-accommodating monetary policies being pursued in most industrialized countries. Inflationary expectations and large budgetary deficits are other major causes. Canada generally continues to support the non-accommodating macro-economic policies being followed by most countries, while recognizing that the weak pace of economic activity engendered by such policies in the short-run is leading to increased pressures on the trading system. Adherence to this policy thrust, however, is not slavish, and takes account of changing circumstances and needs. In view of such risks we have supported attempts at further dialogue in both the GATT and the OECD Group on Positive Adjustment (with the latter being specifically charged to examine the interactions between the macro-economic environment and the trading system). It needs to be recognized, however, that over the medium to longer term, pressure on the trading system will be even greater if demand management policies are not sufficiently firm and consistent to bring about the permanent lowering of inflationary expectations necessary to sustained growth.

It will thus be crucial throughout the decade to restore stability to long-term financial markets to ensure that savings can be effectively channelled into productive investment. The recent downward trend in interest rates and active stock-market trading reflects a gradual return of investor confidence. It will be necessary to build on and maintain that confidence. In addition, a reduction in the federal deficit would ensure that government borrowing is not diverting funds from the capital market and placing renewed upward pressure on interest rates.

Canada's *fiscal regime* is a further fundamental factor determining international competitiveness. As with monetary policy, the basic thrust of the government's current fiscal policies is to control inflation by reducing government expenditures, either directly or through tax expenditures. Complementary to controlling government expenditures is the goal of maintaining a level of taxation (corporate and personal, direct and indirect) which does not place Canadian exporters at a competitive disadvantage.

Industrial democracies rely in large measure on taxes to finance the provision of public goods and services, to mould and shape the level and pattern of economic activity and to redistribute economic resources among various groups in society. In order to minimize any adverse consequence of the imposition of taxes, governments have come to rely on a number of criteria in designing their tax systems. These criteria, which have evolved over time and reflect social, political and economic influences, include the principles of equity, neutrality, simplicity and certainty. However, their application is far from precise. For example, there is no objective measure of equity and a balance must be struck among the criteria in circumstances where they conflict.

It has been suggested that Canada should implement a system of tax measures to provide increased incentives to exports. Part of this desire arises from an impression that Canada's tax system is neutral to exports versus domestic production while other countries actively promote exports. Part arises from a desire to increase exports and thus Canadian jobs. The possible range of measures that have been suggested is large. The 1979 report of the Hatch Committee, for example, contains a number of suggestions, while the 1978 report by the Second Tier Committee on policies to improve Canadian competitiveness summarized the suggestions offered by 30 sector task forces. While each of such proposals raises its own set of issues, each also shares some general attributes, and raise some fundamental economic and tax policy questions.

Part of the concern motivating suggestions for tax incentives for exports is that the Canadian tax system contains few, if any, explicit incentives for exports while other countries' systems demonstrably do. There are two problems with this point of view. First, the question is not really one of whether Canada should match or exceed what other countries do but rather whether the benefits of such a policy exceed the costs to Canada. There is nothing wrong with Canada enjoying the benefits in terms of cheaper imports from other peoples incentives, though this point of view is not often appreciated by producers, even though they benefit substantially from cheaper intermediate inputs. Secondly, it has to be recognized that while Canada's system may not contain many explicit export incentives, its general corporate tax incentives are significant. One thing is certain, however, if the USA succeeds in making the DISC (Domestic International Sales Corporation) compatible with the GATT, the Canadian government would need seriously to consider its implications for Canadian exporters.

Many of the comparisons of alternative tax systems focus on one or two isolated provisions. As well, the case for export tax incentives often rests on the fact that other countries, notably EC members, levy more indirect taxes which are rebated on exports, while Canada has a substantial corporate income tax. However, Canada's reliance on indirect taxes, including the federal manufacturers sales tax and provincial retail sales tax, is not out of line with that in European countries. Moreover, the link between reliance on direct taxes and trade balances is weak. Indeed, if corporate tax cuts did not affect selling prices (which is quite likely) then any switch of such taxes for VAT/sales type taxes would not improve trade balances and could easily worsen them as the increased domestic inflation fed through into a generally higher cost/price structure.

International differences in the over-all level of tax rates, and in the tax structure as it applies in certain circumstances, can have an important effect on growth, capital flows and the ability of Canadian firms to supply international markets at competitive prices. Any major differences could also affect Canada's ability to attract individuals with special technical and professional skills. International trade is a much larger component of GNP in Canada than is the case for many of our trading partners, particularly the USA. The fiscal burden of tilting the tax regime to favour exports more directly would thus be relatively heavier on Canada than elsewhere. Similarly, Canada cannot afford to enter a competitive race to extend subsidized export credits. Moreover, the use of tax revenues to benefit exports implies a

policy choice not to use them for other purposes, such as regional or social development. Finally, there is an additional consideration in the subsidization of non-renewable resource exports, i.e., to do so in effect discounts the intrinsic value of these resources for present and future generations of Canadians. Accordingly, Canada's fiscal regime must take account of our relatively limited capacity to provide tax incentives to export activities, while ensuring that it contributes as much as possible to competitiveness and secures for Canadians the gains from exports, particularly of resource-based exports.

In order to achieve its broad economic development objectives, Canada has historically relied on foreign *investment* to supplement domestically generated capital. The size of the country and the substantial supply of natural resources have dictated a large need for investment in infrastructure and resource development beyond the normal capital requirements of any modern, productive economy. This has required a relatively large dependence on off-shore investors and resulted in a high level of foreign participation in many sectors of the economy.

The government's domestic investment policies have aimed at encouraging the development of Canada's resource wealth, the further processing of these resources, development of indigenous research and development, and the location of productive investment in economically disadvantaged regions. This has been achieved by means of a combination of fiscal measures, loans, incentives, technical assistance and direct government participation in the economy. As a result of the recession, the need for both short- and long-term capital is as acute today as ever. Many companies, in the face of falling demand and high interest rates, cut new investment to the bone. While such a situation is tolerable in the short-term, it now needs to be reversed if Canada is to remain internationally competitive. The capacity of Canadians to take advantage of market opportunities, both at home and abroad, will thus be increasingly dependent upon further direct investment leading to a greater capacity to develop new products, innovate through the greater use of the latest technologies, and a strong research and development performance. The need to encourage this new investment will be one of the major challenges facing government as economic recovery takes hold.

The level of protection afforded to Canadian industries was historically a major factor inducing foreign multinationals to establish subsidiaries in Canada. However, as a result of the gradual and substantial reduction in Canadian tariffs in successive reciprocal international trade negotiations, the customs tariff is now less important in determining the location of investment. Meanwhile, government policies have encouraged many foreign subsidiaries to rationalize their production and to specialize and obtain product mandates as well as mandates to pursue independent research and development projects from the parent corporation to produce for world markets. Many multinational companies are restructuring their operations allowing local companies to produce one product for the world market and using that subsidiary to market the full range of products. Thus, to the extent that this becomes accepted and established by MNEs, the nature of foreign investment will have altered in focus.

The increased role of MNEs in world trade flows has been an important factor in government attitudes towards foreign investment. MNEs sometimes organize operations in a manner that may conflict with the attainment of national objectives. For example, the parent corporation may attach onerous export, procurement, licencing or franchising conditions to the operation of its foreign subsidiaries. Subsidiaries may also be affected by home country laws such as strategic export controls, fiscal policy measures or anti-trust laws. Canadian law and practice is thus geared to ensuring that MNE activity in Canada is of significant benefit to Canadians and Canadian economic objectives.

Because of the continued need for a significant amount of capital from offshore for major resource projects, infrastructure development, and modernization and expansion of manufacturing capacity, policies on foreign investment must strike a careful balance between the need for the high levels of investment required to remain competitive and the need to ensure that foreign investment benefits Canada. While all levels of government have actively sought foreign investment for specific sectoral and regional development purposes, the federal government has introduced measures to address concern about the extent of foreign ownership in particular sectors and to ensure that the terms and conditions of such investment are beneficial to Canada. In some specific sectors, such as energy and communications, such policies are promoting a greater degree of national ownership, control and identifiable benefit to Canada. The trade aspects of these actions (and similar policies in other countries) have given rise to increasing international concern, particularly in the United States. When examining problems raised by foreign investment, distinctions must be drawn between issues raised by new, direct foreign investment, portfolio investment, and foreign takeovers of existing investment. Each requires a different response. Canadian policy regarding foreign investment has been largely directed at new, direct investment. Policy addressing this issue in the 1980s must thus be sensitive to the need for off-shore capital, as well as to the impact of measures designed to increase Canadian ownership and influence the behaviour of MNEs on relations with key trading partners.

In this regard increasing concern has been expressed as to whether FIRA runs counter to the desire to increase Canadian competitiveness, particularly as it affects new, direct investment. This is a theme struck repeatedly by the private sector. There were allegations that FIRA has been used to shield existing Canadian enterprises from the competition of prospective new investors. There is the concern that FIRA operates on the assumption that significant Canadian benefit is not necessarily coincident with the best business judgement of the investor. There is the matter of trying to persuade foreign firms to settle in locations that may not be the most efficient or economical locations for the purpose of longer-term competitiveness. There is the issue of commitments to procure from Canadian sources currently under challenge in the GATT. Finally, there is concern with the FIRA process itself which may discourage some promising firms, particularly those of medium size, from seeking to establish themselves in Canada. To a large extent the streamlining of FIRA's procedures have met the concerns of the business community. Decisions are becoming more transparent and changes have been greeted positively by potential investors. Consideration of the US complaint regarding Canadian "content requirements",

"export performance", and "limitations on distribution activities" has given Canada an opportunity to explain the operation of FIRA. These various issues indicate that the sensible and flexible application of FIRA's mandate and procedures must be considered in ensuring Canadian industry's long-term international competitiveness in a world of rapidly changing comparative advantage.

The other side of the foreign investment coin is equally significant. Trade used to follow the flag. Today, with the demise of the world of metropolitan dependencies, there are not many flags for trade to follow. The modern equivalent is investment. This is one of the developments which spurred the establishment of FIRA, as Canadians feared that much of this type of investment in Canada would not benefit Canadians. Investment has become an important catalyst and funnel for trade and Canadian exporters may not be actively pursuing opportunities to establish themselves abroad. The US market may be serviceable from Canada. The Latin American, European and Asian markets are not. If Canada is ever to hurdle the 2-3 percent barrier of penetration of the EC and Japanese markets, it will only come after Canadian companies have established themselves on the ground. It is the basis of US, Japanese, and German success. Establishment can be achieved in a number of ways including through joint ventures which merge complementary strengths, through offset arrangements, by using the strengths of the Canadian banks already established all over the world, and through aid. In all cases, corporate and governmental links are forged which eventually lead to increased penetration of foreign markets.

c) *Economic Development Policies: Promoting Competitive Industries*

While monetary, tax and investment policies provide the basic economic environment within which Canadians pursue their trading interests, a whole host of *regulatory* policies primarily responsive to domestic concerns, both economic and other, directly affect the competitive position of Canadian producers and manufacturers. The cost of regulation to the economy has been documented by the Economic Council, a Parliamentary Committee, and a Treasury Board Task Force including those involving competition, transportation and manpower policies, labour relations and environmental and safety regulations, over all of which the various levels of government have direct control. It is thus important that those regulations and policies that may significantly and unnecessarily impede achievement of productivity gains or otherwise adversely affect Canada's trade performance be reviewed regularly and kept to a minimum.

Competition policy has served to prevent or reduce artificial barriers to trade and commerce in the domestic economy and to protect the effective operation of the market. Canada's competition and trade policies are largely complementary and mutually reinforcing. The gradual reduction of tariff barriers and increasing international surveillance of non-tariff barriers in the post-war period and the integration of markets have stimulated domestic firms to become more efficient, specialized, innovative and internationally competitive. Because of the relatively small size of the Canadian market, competition law in Canada must accommodate the need for firms in many industries to grow large in order to attain the economies of scale necessary

for efficiency and competitiveness. As a result, a greater degree of industrial concentration in Canada can be tolerated than in most other jurisdictions. In such circumstances, Canada will rely more heavily on foreign competition to preserve an effectively competitive domestic environment.

One aspect of competition policy may currently be inhibiting Canada's trade performance. The law affecting the establishment of export consortia now inhibits Canadian exporters of many manufactured products from entering into such arrangements in order to enhance their sales. The Act allows the formation of export consortia only if they do not unduly lessen competition in the domestic market. This in practice affects most directly exporters of standard technology products at various stages of processing, especially if they manufacture similar products for the domestic market. In recognition of the hardship the Act may be imposing on exporters, amendments are being considered which would allow unlimited formation of export consortia as long as their activities relate solely to exports. A number of other contemplated amendments should also ensure that the Act does not stand in the way of gains in efficiency and productivity. Overall, it is important that the administration of this Act starts with the presumption that the market-place is the international market.

The large dependence of the economy on exports has required government programmes and policies to ensure that Canadian goods are rapidly *transported* to international markets at competitive cost. The continued expansion and modernization of domestic handling and export delivery systems and other infrastructures facilities are crucial to Canada's competitiveness, especially for bulk commodities. To this end, the government has committed substantial expenditures over the next few years to develop the infrastructure for new grain and coal terminals at Prince Rupert, to expand the Robert's Bank terminal at Vancouver thereby improving Canada's coal shipping capacity, to improve port handling facilities at Montreal, Saint John and Halifax, and to stimulate modernization and expansion of the western rail system. These projects will play an important role in removing current capacity constraints in the transportation system. Furthermore, the export performance of the resource-based sectors in Western Canada in the 1980s will be influenced by decisions on a rate-setting system for all modes of transportation that would remove transportation bottlenecks in that part of the country. The gradual deregulation of the transportation industries would further assist in inducing competitiveness and productivity.

Effective *labour* adjustment will be a key determinant of the success of the federal government's strategy to revitalize industrial capacity towards specialized international competitiveness. Expansion of existing firms and creation of new economic opportunities—the upside phase of the adjustment process—is dependent upon an adequate supply of skilled labour. Productivity improvements inherent in the development and application of high technology will not be achieved if the necessary skilled labour is missing. Human resource policies to facilitate positive adjustment must, therefore, focus on ensuring adequate supplies of skilled labour to meet high regional or occupational demands for such labour.

The present concern with skill shortages extends beyond continuing attempts to improve the process whereby available labour is matched with existing vacancies. Chronic shortages in certain skill areas are apparent, coinciding with those sectors which are expected to play a significant role in economic renewal. Of particular concern are shortages in occupations essential for the expansion of natural-resource and high-technology industries. While the federal government devotes extensive resources to evaluate and train Canadians, domestic supply channels for skilled labour have not functioned very well. Immigration has been used extensively to meet Canadian needs, but the growing international competition for skills will reduce the importance of this mechanism in providing skilled workers.

Another significant aspect of labour adjustment is that resulting from contraction in certain industries. Continuing tariff reductions and consequent industrial restructuring and productivity improvement will increase the importance of effective downside adjustment, since the rapid movement of capital out of declining sectors and into growth areas is a fundamental aspect of this process. The impact of downside adjustment on labour will often be severe, depending upon national and regional economic conditions and the nature of the labour force. The concentration of costs (on workers who will lose their jobs) and the wide dispersion of benefits (to consumers and workers in general) imparts a significant political dimension to the downside adjustment process. Protectionist policies which avoid labour adjustment by continually subsidizing non-competitive and declining firms or industries are one means of dealing with resistance to adjustment. A more efficient approach, however, may be to develop strong worker adjustment and assistance policies, incorporating elements which would promote industrial adjustment, such as compensation for the displaced, retraining and mobility assistance.

The international competitiveness of Canadian industries is also influenced by our industrial relations climate. Achievement of Canada's full export potential will require fuller cooperation among labour, business and government, reflecting the requirements and discipline of the international market-place and the need to enhance Canada's image as a reliable supplier. In the past decade Canada's record has been less than satisfactory. Labour costs have increasd at a much faster pace than gains in productivity. We had one of the highest rates of work stoppages due to strikes and labour unrest in the OECD. The 1980s must see a return to Canada's reputation as a reliable and competitive supplier.

It is important to note a potential fundamental conflict between trade and human resource objectives. A strategy which focusses on improved trade performance and includes reducing protectionism and improving international competitiveness and productivity, may result in temporary job losses. To the extent that our trade performance improves, jobs will be created. The net result in terms of employment creation is not yet clear. However, if recent estimates of continuing high unemployment are correct, the conflict between improved long-term productivity and maintaining short-term jobs will become increasingly apparent. This will have obvious implications for the speed at which downside adjustment is encouraged.

In the highly competitive international environment of the 1980s, a more efficient and internationally competitive *industrial base* will be critical. In addition to a

greater coordination and coherence between trade policy and various domestic economic policies, a fundamental dimension of the government's economic development priorities for the 1980s must be the encouragement of continuous modernization and rationalization of the nation's industrial base, as well as the promotion of new and alternative employment opportunities. The success of these efforts will be a factor critically important to Canada's trade performance during this and the next decade.

Further processing of Canadian natural resources (agriculture, fisheries, forestry, petrochemicals, metals and minerals) prior to export where feasible and economically competitive has been a major objective of regional, industrial and trade policies in Canada. The removal of foreign trade barriers on semi-processed and processed resource products has been a primary Canadian objective in various international trade negotiations. Although some progress was achieved, particularly in respect of forest products to the US market in the Tokyo Round, substantially more needs to be done, especially in the markets of Western Europe and Japan. Further processing is beneficial, however, only if it leads to competitive goods for export—if not, the Canadian economy loses in two ways. We do not gain the market for the more processed product and lose the market for less processed goods as others less concerned about processing fill the vacuum. It must be recognized that there will always be a market for less processed goods which we cannot afford to neglect.

Similarly, the exploration, development and processing of Canada's resources have contributed significantly to the development in Canada of resource-related machinery and equipment. Indeed, a major government policy objective in relation to anticipated major resource and energy projects to the year 2000 is encouraging the further development of an internationally competitive industrial and regional base for machinery, equipment and related engineering and consulting services. This provides opportunities not only to achieve industrial and regional benefits from major resource projects but also to strengthen linkages between Canada's resource and secondary manufacturing sectors and regions. These linkages should help Canadian industries exploit opportunities in world markets.

The progressive restructuring of a number of manufacturing sectors is central to Canadian economic development. *Industrial renewal* by the private sector involves efforts both to encourage adjustment out of less efficient activities and to take advantage of new or emerging market opportunities. Government policy and activity is limited to ensuring that there exists a climate conducive to industrial renewal. Firms which do not adapt and respond to change face stagnation and decline. Although most industrial adjustment occurs smoothly in the normal course of business life, many companies in industries engaged in labour-intensive and/or standard-technology activities (for which international comparative advantage is rapidly shifting towards the newly industrialized developing countries) have not successfully responded to industrial renewal and have come to rely on various import relief measures. Such special border protection is intended to pace industrial restructuring in a way that smooths out the process and avoids unreasonable social and community dislocations. It is not intended to shield Canadian producers from international competition and the burden of adjustment. A number of complementary funded programmes has been introduced to assist capital, labour and communities to adjust to changing competitive circumstances and improve the allocation within Canada of

capital and human resources. The Industry and Labour Adjustment Program and the Canadian Industrial Renewal Board are two major recent initiatives designed to help Canadians to adjust to industrial renewal in the 1980s.

The capacity of domestic producers in different regions to compete at home and abroad is significantly influenced by the extent to which innovative technology is applied. *Industrial innovation*, i.e., the process of commercial application of fundamental R&D, new materials, production processes, products and systems, is fundamental to improved productivity, efficiency and international competitiveness. Various studies have demonstrated that companies that spend relatively large amounts on R&D (and the application of R&D) have significantly higher growth rates, greater improvements in productivity, export more, and have a better record in controlling inflation and in creating employment. While innovation is most often thought of in terms of advanced technology (e.g., aerospace and electronics), innovation in fact permeates both advanced- and standard-technology industrial activities. Innovation in production process through numeric control, robotics and other elements of computer-aided design and computer-aided manufacturing (CAD/CAM) will thus be vital across a wide range of Canadian industrial activities.

To date, Canada's innovation performance and the industry's response to the technological challenges have not made the best use of Canada's human, capital and natural resources. The end of a recession may not seem a propitious time to consider industrial renewal and innovation. Yet it is in fact the best time. It is in the earliest stages of recovery that greatest progress can be made. Canadian firms, with some notable exceptions, have tended to be technological followers with limited indigenous R&D capabilities, relying on foreign sources for new technology. Over the longer term, strengthening the manufacturing sectors' performance will require more indigenous R&D, greater use of the most advanced technology available, and more aggressive commercial application of R&D by the private sector. Furthermore, it will be essential to ensure that the necessary investments are forthcoming to keep Canada at the forefront of product and production technology. Finally, it may require more government support and incentives for R&D performed and applied by the private sector.

The nature and magnitude of the challenges posed by industrial adjustment and innovation will require the pursuit of mutually supportive domestic and international policies. Exports need to become an increasingly significant dimension in corporate decisions in order to achieve economies of scale, etc., stimulated by a large market. Liberal and secure access to foreign markets will be more important than ever for the attainment of industrial development objectives, particularly if firms are to make the necessary and substantial investments in products and production processes in areas of Canadian comparative advantage. Similarly, imports of technology, either through industrial purchases, licensing arrangements, or in the form of capital equipment not competitively available in Canada, will continue to foster industrial innovation and increase the productivity of Canadian industry.

Conclusions:

- The pursuit of Canada's trade objectives will require a full appreciation of domestic and international concerns and of the interrelationship of domestic

policies (monetary, fiscal, investment, industrial and transport) with trade policy.

- Meeting Canada's trade objectives will require careful attention to the trade effects of micro- and macro-economic policies and further consideration of tax incentives for exports and the free flow of capital.
- There is no substitute for cost and price competitiveness and aggressive marketing activities by the private sector to secure access to international markets.
- Continuous industrial renewal and use of the latest technologies will be crucial to Canada's ability to compete. A stronger indigenous R&D performance will be critical. The adjustment of less competitive activities will continue to reflect a balance between the need for greater efficiency and for equity in terms of those directly affected.

IV. **Sectoral Perspectives:** Towards World-Class Industries

Enhancing the opportunities of various sectors of the Canadian economy and its regions to expand investment and production facilities and create jobs offered by further penetration of world markets will be central challenges of a sound and balanced trade policy. Increasing world demand for Canada's metals and minerals, agriculture, fishery and forest products, as well as energy and energy-based products, offers substantial opportunities in the 1980s for the further development of resource-based industries in different parts of the country. For other manufacturing and service sectors the expertise and advantages, already achieved or potential, offer opportunities in selected world markets for a range of advanced-technology and high-productivity exports.

In a world experiencing rapid population growth and increasing requirements for food proteins, Canadian *agriculture* industries are in a favourable situation to take advantage of large and expanding world markets. The thrust of the Canadian Agri-Food Strategy reflects this potential. It emphasizes, however, the need for better management of the land base and water resources and for removal of a number of production and marketing constraints, including the rail transportation bottlenecks for bulk commodities like grains. A great deal of effort will be required to protect the agricultural resource base at its current level of exploitation, let alone at a materially increased level. The trade-distorting and restrictive practices maintained by agricultural competitors, particularly the EC, will remain a constraint. It will also remain necessary to deal in a timely and effective manner with disruptive seasonal import pressures in horticultural products. A more recent threat is the prospect of a subsidy war between the USA and EC for exports, which heightens the need for multilateral discipline in agricultural trade. All these elements are the subject of intense activity in the GATT. Finally, it will be necessary to pursue aggressive marketing strategies to develop new commercial markets and maintain existing ones for a broad range of viable and competitive agricultural and food products.

With 80 percent of its *fishery* production going abroad, Canada has become the world's leading fishery exporter. Both the Atlantic and Pacific coast fisheries

have been subject to special examination, the results of which have important implications for government policies in the 1980s. The industry's contribution to Canada's regional and industrial development will be closely tied to its success in export markets and its capacity to improve quality control and industrial efficiency. Existing dependence on exports may even be accentuated with the successful management and replenishment of fish stocks within the 200 mile economic zone. Policies in support of this sector will thus need to focus on improving marketing, quality control and industrial efficiency. Marketing activities will need to consolidate existing, as well as find new, export markets. On the trade policy front, we will need to pursue Canada's rights in relation to measures inhibiting our exports such as EC preferential arrangements, Japanese quantitative restrictions and unwarranted US countervailing measures, as well as to seek substantial improvements in foreign market access conditions. To this end, the federal government is actively pursuing an initiative in the GATT which aims at improving access to markets and multilateral disciple on trade in fishery products.

Non-renewable resource industries are generally well-positioned in terms of cost competitiveness insofar as existing production is concerned to continue to take advantage of international market opportunities. The mining industries may be experiencing some local resource depletion, and the geographic remoteness of new domestic mineral resources will act as a constraint on the economics of resource processing and may require significant investment in infrastructure. Some of the older, established non-ferrous metal plants in Eastern Canada will need to undertake significant restructuring to meet, *inter alia*, more stringent environmental standards. Foreign non-tariff barriers, increased competition from new suppliers, the growth in intra-corporate trade, and deliberate diversification in buying patterns on the part of some of our major customers all represent constraints on Canada's increased participation in world mineral markets. The need to continue to improve market access conditions abroad for more processed products, particularly in Japan and the EC, will remain of priority concern. It will be equally important to recognize the increasingly close relationship between the capacity of Canadian industries to develop new markets in developing countries and to pursue direct invest abroad, joint ventures and industrial cooperation. It will be important to preserve existing market access conditions against unnecessary obstacles to trade or disguised foreign protectionist measures affecting products such as asbestos. Furthermore, new technological developments including new materials such as fibre optics will present challenges to some conventional commodities like copper.

As the economy emerges from the recession, opportunities for the *forest-products industries* are reasonably bright; they should continue to experience growth. There will be continued pressure to complete the restructuring initiated in the pulp and paper sector in the 1980s. As well, the sector faces some serious regional supply problems which challenge government and industry to manage resources carefully and more deliberately. Mutually advantageous opportunities for industrial cooperation are anticipated for the 1980s and must be effectively exploited. It will be important to improve existing market access and resist protectionist measures. There is room for further industrial and technological cooperation and the use of common standards and testing facilities in regard to, for example, wood frame construction techniques in Europe and Japan.

The *energy* field in the 1980s is likely to continue to be dominated by Canada's continuing struggle for oil self-sufficiency and uncertainties pertaining to the world market. The further implementation of the NEP should assist in this effort. Trade relations in oil and gas will continue to be heavily influenced by national energy policies of both importing and exporting countries. Nevertheless, the years ahead will present growing export opportunities for commodities such as gas, coal, uranium and electricity and offer prospects of contributing significantly to greater diversification of Canada's trade. This will require a fully articulated export policy. In respect of nuclear industries, which have been an example of Canadian technological leadership and excellence, the medium-term conditions, particularly the financing implications, are expected to remain difficult. In addition, it will be important to resist protectionist measures such as, for example, quantitative restrictions on uranium imports into the USA.

The availability of price-competitive feedstocks will continue to be a major concern for Canada's *petrochemical* industry and a major determinant of the industry's international competitiveness. There has in recent years been significant rationalization and restructuring reflecting changing patterns of world trade. Although the competitive positions of the Western and Eastern Canadian petrochemical complexes vary significantly, improved foreign market access and the maintenance of stable market access conditions, particularly in the US market, will continue to be of vital importance to this industry. There is room to explore the possibility of sectoral arrangements to expand international trade on a mutually satisfactory basis.

Canada's *secondary manufacturing* industries in the 1980s will face both downward competitive pressures and new opportunities. The solutions are clearly not going to be simple. They will require close co-ordination of industrial and trade policy instruments.

In the *automotive* sector, with further moves towards the building of a "world car" involving production of different parts in a variety of countries and assembly in more local markets, problems may only be resolvable within a multilateral context. It will be important to ensure a reasonable and equitable share of North American production capacity and employment, including both parts and assembly, in Canada. Equally important will be continued cooperation with the USA in developing common solutions to common trade problems vis-à-vis third countries, as well as new opportunities for industrial cooperation and production sharing in, for example, the parts sector, and seeking out export opportunities for parts manufacturers in countries such as Japan.

The *consumer-goods* industries face the greatest pressures on the domestic market. It will thus be important to maintain policies and programmes in support of viable and more internationally competitive production facilities in textiles, clothing, footwear, and tanning industries and to assist labour and the communities concerned to shift gradually into alternative employment activities. The challenge will be to deal effectively with disruptive imports while adequately reflecting consumer interests and facilitating gradual and orderly adjustment of the domestic industry. This will be facilitated by cooperating with other countries to maintain and observe international trade rules in products such as apparel, while increasing the export orienta-

tion of the more competitive segments of the consumer-goods industries through marketing and appropriate market access initiatives. As well, there may exist opportunities for industrial cooperation and rationalization along North American lines.

Advanced-technology manufacturers in sectors such as urban transportation, aircraft and electronics, have become strong performers in the economy and important contributors to a more balanced regional structure in Canada. They are internationally competitive and heavily export-oriented (e.g., 75 percent for urban transportation, 85 percent for aircraft and avionics and 54 percent for electronics), although relatively small in employment terms. Very specialized lines of production for international markets have been developed, based partly on technology imported from abroad and adapted within Canada and also on significant indigenous R&D components. While international competition is fierce, there is room for further Canadian achievement. The capacity of these industries to sustain further growth will require continued access to the latest technologies, continued government support for R&D and marketing activities and improved and secure access to major markets, including the markets of developing countries. Access problems in developed markets relate particularly to restrictive government procurement practices and to concessional government export financing, both of which are subject to active multilateral consideration. Foreign tariffs remain a barrier, although of a generally modest level; tariffs on aircraft and related products were largely removed as part of the Tokyo Round, but there remains room to expand the coverage of the Aircraft Agreement. There is scope for exploring the possibility of further sectoral free-trade agreements that would also deal with the practices of MNEs and concessional export financing.

A major development in the Canadian industrial and trade structure in the last fifteen years has been in the *machinery and equipment* sector. Since 1965 this large industry has become substantially internationalized, with the percentage of domestic production going to exports jumping from 20 to 50, and with the percentage of domestic requirements being filled by imports rising from 54 to 65 percent. This substantial industrial restructuring reflects a considerable degree of specialization and rationalization as well as a growing capacity to meet the technological requirements of export markets, particularly in the USA. These developments have been strongly encouraged by various government policies and programmes, such as the Machinery Program, and support for industrial R&D enabling more world-product mandating. These efforts should be continued and complemented by seeking effective international rules to liberalize restrictive foreign procurement practices and a greater harmonization of the procurement practices of the federal and provincial governments within Canada. It will also be important to actively support the development of international discipline to contain the subsidization of export financing.

The prospects for capital equipment producers to compete on a fair and full competitive basis for both domestic and foreign *major projects*, present significant challenges for the industry. The modernization of the Canadian import regime and a strengthened capacity to deal with injurious subsidized or dumped imports, particularly due to foreign concessional export financing, should improve the general competitive environment for this sector. In respect of export opportunities, particularly in developing countries, the capacity of Canadian industries to respond will be signifi-

cantly influenced by the effective marshalling of its resources to undertake turnkey projects. Canadian participation in major projects, both at home and abroad, can take place at two levels: overall management of a project and participation in a project led by a foreign firm. Both pay dividends and are worth exploring.

To a considerable degree, the development of the *electrical machinery* and equipment producers has followed a pattern similar to that of the overall machinery sector. This may be accentuated in the 1980s as the domestic market is not expected to grow significantly. Foreign market access conditions are influenced by various restrictive government procurement, industrial support and regulatory practices. With respect to heavy electrical equipment, restrictive foreign procurement practices and concessional export financing remain the major obstacle to the expansion of Canadian exports.

Services, ranging from banking to communications to consulting to education, account for 65 percent of Canadian GNP and over 12 percent of export earnings. The breadth of this sector is immense and there is not a precise definition of what constitutes trade in services. The importance of the service sector relates both to the provision of services per se, and the linkages it can provide to the export of goods, an aspect which can benefit from much greater emphasis in Canadian exports. Nevertheless, for engineering, construction and related consulting services, as much as 20 percent of their receipts are derived from exports, 80 percent from developing countries. Trade in services has become the subject of international attention, but it is too early to see whether or not this will result in trade negotiations on services. The interest displayed by the US government in the service area poses the risk that this may result in pressures on its trading partners to join it in efforts to develop greater international discipline, or risk protectionist actions reducing access to the US service economy.

Canada's *cultural industries,* while not traditionally considered in terms of trade and industrial policies, represent an economically significant and labour-intensive element of the Canadian economy. Exploration of the trade potential of Canada's cultural industries has hitherto been handicapped by the impact of foreign cultural domination of the domestic marketplace, and by the absence of a global federal cultural policy within which to situate any trade initiatives. The Federal Cultural Policy Review Committee, however, in its report to the federal government suggested ways and means to assist the strengthening of Canada's cultural infrastructure. Cultural trade policies can then be developed as corollaries of any domestic initiatives to help increase the Canadian share of both the domestic and foreign cultural markets.

The pursuit of Canada's cultural interests abroad has a dual objective. Cultural industries in Canada generate an annual investment estimated at $8 billion and their future success depends heavily on their ability to penetrate and develop the markets of our traditional partners. In addition, Canada's cultural presence is used, and should be used more intensively, as an instrument of support for strengthening bilateral relationships with those key countries relevant to Canada's long-term interests. In a number of cases, the cultural instrument can be effectively used in

strengthening some of these non-traditional relationships which have to be built "from the ground up".

Conclusions:

- Overall, Canada's export-oriented industries continue to be well-positioned to participate in world markets. The challenge in the 1980s is to expand the markets and the number of industries that export and to create an environment within which efficient companies can increase their participation in export markets.
- Canada's bread and butter in trade will continue to be gained through opportunities in world markets for a range of agriculture and fishery products, resource-based products, capital equipment and a range of advanced-technology products and services.
- Competition for advanced-technology products will be especially fierce but there is scope for significant Canadian participation. Canada has already built its own strong areas such as urban transportation, telecommunications and power-generating equipment. Improved access to export markets for these sectors is basic, particularly with respect to restrictive foreign government procurement practices.
- The standard-technology secondary manufacturing sectors will continue to be challenged to adjust and restructure to meet off-shore competition.
- Energy trade will remain important as efforts to achieve oil self-sufficiency continue. There is substantial export potential (coal, uranium, natural gas), including to Europe and Japan. It will be important to develop a coherent export strategy. The conditions facing the nuclear sector will continue to be difficult.
- Central challenges of a sound and balanced trade policy will be the enhancement of opportunities of diverse sectors of the economy and of different regions to expand production facilities and creates jobs through further penetration of world markets.

V. The Role of Commercial Policy

Canadian commercial policy over the post-war years has sought to improve access for Canadian exports to foreign markets; to maintain an open global trading system thereby ensuring that major traders deal with us multilaterally rather than through bilateral deals and/or pressures; to maintain an adequate level of tariff protection while gradually reducing tariffs in the context of multilateral trade liberalization; and to provide effective mechanisms for dealing with injurious imports and disruptive changes in trading patterns. This has been a dynamic process responding to constantly changing economic conditions, both in Canada and abroad, and encompassing a framework of laws, regulations, policies and programmes which directly or indirectly condition Canada's import or export activities. It has required a constant

balancing between the interests of domestic producers and consumers, between the interest of different regions, and between the need to protect the domestic market and enhance access to foreign markets for Canadian exporters. The ultimate test of these policies is that they contribute to an economy in which Canadians can find rewarding jobs and satisfy their needs from a wide variety of competitively priced goods and services.

a) *Maintaining and Improving Access to Markets*

Access to markets is crucial to the health of the Canadian economy. Preserving and enhancing the stability of existing foreign market access conditions and seeking further improvements to the markets of the USA, Europe, Latin America and Asia for agriculture, fisheries, processed industrial resource products, a range of manufactured and advanced-technology goods and related services will thus remain a central condition for sustaining and enhancing profitability of producers and achieving the necessary efficiency and economies of scale. The level of access to foreign markets, particularly the USA, achieved over the years now provides the kind of market basis which many Canadian industries have needed to achieve the necessary economies of scale and provides a strong base for further expanding and diversifying Canadian exports. Preserving that market access will require active monitoring and assessment of foreign laws, regulations and practices to assist Canadian firms to take full advantage of negotiated access. In particular, we will need to ensure that the liberalization achieved during the Tokyo Round is fully implemented, including a full and effective adherence to the non-tariff measures agreements. As well, we will need to prevent the impairment or nullification of Canada's rights through unwarranted recourse to contingency import protection (i.e., anti-dumping, countervail and safeguards) and other border measures inconsistent with international rules.

A wide range of Canadian exports of resource-based products and machinery and equipment will enter the USA duty free (e.g., aluminum, agricultural machinery and implements, pulp and paper-making and metal-working machinery, and aircraft, engines, avionics and parts). Other products face relatively modest tariffs in the 3 to 5 percent range. Nevertheless, there will remain significant market access barriers with duties on important and export-oriented sectors such as rolling stock being high, i.e., 15 percent or more. Other sectors, which are now not export-oriented, could on a selective basis become so with a reduction in barriers, for example, to exports of textiles and clothing. In some sectors, while tariffs remain high, e.g., petrochemicals, they are not unduly constraining investment in Canada and the development of export-oriented industries.

Perhaps more importantly, a number of non-tariff barriers such as 'Buy America' legislation and practices at both the federal and state levels severely impede access of Canadian exports and, in some important cases, induce domestic producers to establish plants in the USA to bypass these barriers. The threat of even more such non-tariff barriers is ominous. Congress has already passed a number of restrictive measures that have had the effect of reducing the access Canadian manufacturers formerly enjoyed in the defence sector. There is also the whole complex of contingency import protection that can be brought to bear on Canadian exports. To a considerable extent, the administration of these laws and regulations has been

brought under international rules, but they remain sensitive to various domestic pressures which are likely to affect Canadian trade interests. This sensitivity is particularly acute now given the spate of reciprocity legislation being considered by Congress and the generally protectionist mood south of the border in reaction to the economic downturn.

Canadian access to Japan and the EC is not as open as that to the United States, although the tariff structures of these three large trading units do not differ very significantly overall. Canadian export interests in Japan and Europe are much more heavily concentrated in resource-based sectors; but, in these areas, the import regimes are relatively more restrictive than in the USA, and in the case of the EC there exist broad preferential arrangements providing better access for some developing countries, particularly for resources in their more processed forms. The markets of developing countries offer substantial opportunities to supply their import needs, although competitive access is not fully guaranteed by commitments under international agreements. As a result of special bilateral arrangements, the markets of Australia and New Zealand should continue to provide stable access conditions.

Improving access to markets will in the first instance require continuous and vigorous participation in the GATT work programme established at the GATT Ministerial meeting. As discussed below, the work programme offers many opportunities to improve the predictability, stability, and openness of world markets. These multilateral efforts can be supplemented by bilateral initiatives, including sectoral arrangements with the USA. Government can assist by providing a vigorous defense against unwarranted protectionist measures which erode the access gained and paid for over the years. Finally, efforts by Canadian business should clearly concentrate on markets with identifiable potential. Businessmen will always use their resources where they can make the most gains and government should support this natural tendency. Consistency of policy will assist them to develop a healthy balance between short and long term interests.

b) *Protecting an Adjusting Economy*

Canada traditionally had a relatively high tariff, reflecting the needs of domestic industry. However, the large number of special provisions in the Customs Tariff providing duty-free treatment responding to the interests of various industrial users, consumers and regions have resulted in duty-free treatment for over half of the imports entering Canada. Meanwhile, Canadian tariffs have been reduced significantly due to the cumulative results of the various rounds of GATT negotiations, and are now less central instruments of commercial policy. When the reductions negotiated in the Tokyo Round have been fully implemented, the average level of tariffs on dutiable imports will be between 9 and 10 percent, but in some sectors such as textiles, clothing, footwear and ships the tariff will continue to exceed 20 percent. Taking into account duty-free imports the overall incidence of the tariff will be in the 4 to 5 percent range. Canada will thus continue to have some tariff protection to promote viable production and to serve as a bargaining instrument to facilitate the negotiation of improved access to foreign markets for Canadian exports.

As in other countries, much of the pressure for protection against imports in future will focus on non-tariff instruments such as anti-dumping duties, countervailing duties, quotas and surtaxes, the so-called measures of "contingency protection". These instruments of contingency protection are governed by international rules in the form of various GATT Codes. Legitimate recourse to these instruments does not constitute protectionism. The existence of an adequate safety net of contingency protection is regarded internationally as an essential requirement for the maintenance of an open trading system based on the rule of law. Recourse to these rights is subject to various conditions, of both a policy and a procedural nature, and may be challenged when considered inappropriate or excessive by trading partners.

The shift from a system of protection based primarily on the tariff to one which responds quickly to changing economic conditions and trade practices has advantages as well as disadvantages. Contingency measures of protection have the advantage that they can only be implemented when it is clear that the imports are injurious to domestic production and for such time as may be required to eliminate the injury, but they carry the risk of being implemented in ways that constitute new non-tariff barriers. Further, as this kind of system responds to injurious situations, it can be expected that greater pressures will be brought to bear on administrators to act precipitously without having an adequate information base, particularly regarding the available evidence of injury. The scope for harassment of exporters is evident. In considering increased or special protection for a particular industrial sector, due recognition will need to be given to the potential negative impact such action may have on industrial competitiveness, economic welfare, and the international trading system generally.

A comprehensive revision of the legislative and institutional aspects of the Canadian import regime should be completed by the mid-1980s. The tariff reductions negotiated in the Tokyo Round will be in effect; the legislative and regulatory actions resulting from the current Tariff Board studies of the GATT customs valuation system, of the made/not made in Canada regime and of the General Preferential Tariff should be in place; the question of adopting an internationally harmonized system of customs tariff classification will be resolved; the legislative proposals contained in the Discussion Paper on Import Policy dealing with anti-dumping duties, countervailing duties and safeguard measures (i.e., surtaxes and quotas), as well as the proposed revisions to the Customs Act should all have been implemented. In addition, the government will have reviewed the tariff structure facing the shipbuilding industry, including on ships for use in coasting trade; the implications of extending national customs and excise jurisdiction to the Canadian continental shelf; the extension of coasting trade legislation to all commercial coasting and marine offshore activities, except fishing, within the 200-mile economic zone; the possibility of establishing duty-free trade zones in appropriate slow-growth areas; and the possibility of establishing duty-free shops at Canadian ports of entry for purchases of goods by travellers upon arrival in Canada. Furthermore, by the mid-1980s the computerization of customs-entry documentation should be close to completion, facilitating customs entry as well as making available more timely statistical information for public use. Finally, if the government adopts the recommendation of the House of Common's Sub-Committee on Import Policy for a study of the interrelationships between the Anti-dumping Tribunal, the Tariff Board, and Textile and Clothing

Board and the Special Assessment Programs Branch of Revenue Canada, all major elements of the import system will have been examined and updated to reflect Canada's current needs in this area.

The various revisions to Canada's import regime are intended to ensure that the government has the necessary legislative authority to implement a regime which meets the modern requirements of Canadian industry, which takes full advantage of Canada's rights under the GATT, and which provides a system as effective and efficient as that of our trading partners. These objectives fully recognize the need for a balanced approach to our commercial policy, namely, an import regime that provides a legislative and regulatory framework similar to that in place in other countries while not adopting unwarranted protectionist measures which do not take account of the interests of consumers, of regional sensitivities, of the need for industrial restructuring, or which may be regarded as precedents by other countries and subsequently used against Canadian exports. Canada's record in this regard is neither better nor worse than our trading partners—in trade policy there are no "boy scouts". At the same time, an effective Canadian commercial policy requires a vigilant defence of Canadian export interests and rights that may be affected by the practices of other countries. However, having a system of contingency protection in place does not remove the need for governments to make judgements in each case on the appropriateness of a specific action in light of the balance of interests involved. Similarly, the import regime cannot reasonably be expected to cushion the full impact of the competitive pressures on the domestic market. It must be seen as just one aspect of a number of mutually supportive and reinforcing domestic economic and industrial policies and programmes. A dynamic and growing economy which hopes to sustain and enhance such growth and wants to compete in international markets cannot afford the luxury of isolating itself from the forces of international competition. To quote the Prime Minister:

> We cannot avoid the competition. We must keep our home markets open to the products of others in order to secure access to their markets for our products. So we must meet the competition, at home and abroad.

c) *Export Controls Policy*

While the purpose of commercial policy is to promote the efficient development of the Canadian economy, commercial policy instruments are occasionally used for other reasons, including trade embargoes, controls on strategic exports, and prohibitions on imports of obscene literature. Resort to commercial policy instruments for such reasons, however, needs to be carefully considered to ensure that the intended effect will be met and the benefits outweigh the disadvantages of distorting or limiting trade. In this regard, increasing resort to export controls for various foreign policy reasons (such as human rights, and East-West relations) has raised concerns about both the adequacy and extent of these controls.

The need for some form of controls is obvious, but there remains a need for broader agreement, both domestically and among industrialized countries, on the practices and criteria which govern their application. Canada should play a full and active role in efforts to improve the consensus and seek to provide greater clarity and

assurances to the private sector in order to facilitate long-term investment plans necessary to efficient production of advanced-technology and military equipment. Equally, the government must ensure that Canadian producers are not discriminated against by attempts by other countries to implement controls on an extra-territorial basis.

Conclusions:

- There will be a continuing need to reduce foreign trade barriers in order to improve access conditions for efficient Canadian producers. Canada must use both multilateral and bilateral instruments and techniques to achieve this objective. We must be vigilant to counter discriminatory treatment affecting exporters.
- The level of access to the US market achieved over the years now provides the kind of market base which many Canadian industries need to achieve the necessary economies of scale and provides a strong base for further expanding and diversifying Canadian exports. There remain some important areas where improved access is needed (e.g., petrochemicals, urban transportation). This access also needs to be protected from unwarranted protectionist measures.
- The Canadian import regime is being modernized to deal more effectively and expeditiously with problems of injurious import competition in the domestic market and to ensure that our system of contingency protection is as effective as that of other countries. The Canadian tariff will continue to provide reasonable protection, but its gradual reduction should help to mitigate regional tensions on trade policy matters. The tariff will also become a less determinant factor in MNE decisions on the location of new investment.
- There is a clear need to continue to contain resort to safeguard action to emergency, short-term circumstances to deal with injurious, disruptive increased imports. There may be cases where they can be combined with other programmes to facilitate longer term industrial adjustment, but their indiscriminate use could actually impede the adjustment process.
- The use of export controls for strategic and non-commercial policy reasons should not unduly frustrate the achievement of commercial policy objectives.

VI. Developing Markets

a) *Assisting Competitive Exporters*

In order to assist Canadian producers to take full advantage of access to US, Japanese, EC and other markets, a wide array of export development programmes have been put in place. These range from posts abroad staffed by trade commissioners, through the Programme for Export Market Development (PEMD), to the Export Development Corporation (EDC). These programmes are not, of course, a substitute for international competitiveness on the part of Canadian exporters nor for adequate support by the Canadian banking system. The private sector must ensure

that they have the right product at the right price for the right market and pursue aggressive and sustained marketing activities to expand existing and develop new export markets. Provincial governments have also increasingly become involved in export market development activities, largely with programmes complementary to federal initiatives.

Both federal and provincial programmes are essentially aimed at facilitating the entry into international markets of small and medium-sized companies. Large companies usually have the necessary infrastructure and sales force to penetrate foreign markets. Smaller companies, however, often lack the resources and expertise, especially for the initial assessment of potential markets and for developing customer relations. Experience has demonstrated that once a company gets the export habit, it keeps it, and federal and provincial government assistance at the initial stage proves to be an investment that pays dividends to all Canadians. What is needed, therefore, is a mix of policies and programmes which encourages the development of an aggressive and self-reliant economy to which exporting is second nature.

Government export promotion programmes should also aim primarily at developing new markets or introducing new products and companies to world markets. According to the European Management Forum, Canada has one of the worst records in the OECD in expanding exports to new markets. The EMF gives a range of reasons including attitude, experience, and expertise. A further factor relates to the constraints (and advantages) imposed by Canada's corporate structure, dominated as it is by a large number of foreign-controlled MNEs. The suspicion is that Canada lacks a sufficiently diversified and venturesome exporting community. Export promotion programmes should thus in part build export awareness and expertise and in part support exporting activities. They cannot substitute for a private sector alert to opportunities around the world, eager to respond to enquiries, willing to visit the market regularly, tailor its goods to markets, and most importantly, with an attractive and competitive product for sale.

In 1980, following the exhaustive enquiry into the federal government's market development policies and programmes by the Hatch Committee, the government reviewed its programmes and adopted an export development strategy. This strategy includes such elements as detailed marketing strategies for priority countries; focussing federal export programmes on growth markets and competitive sectors to maximize the use of available resources; according greater weight to economic and commercial affairs in Canadian government services abroad; increasing emphasis on matching Canadian supply capabilities with foreign market opportunities; and expansion of EDC financing facilities, including the introduction of a three-year, $900 million "crédit mixte" facility to match international competition.

There remains, however, significant work to be done, including strengthening Canada's market intelligence capacity and facilitating the dissemination of information to Canadian firms through further computerization; encouraging a greater utilization of the international networks of Canadian commercial banks; increasing commercial returns to Canadian firms under multilateral and bilateral foreign aid programmes; facilitating co-ordinated bidding capabilities by Canadian manufacturing and engineering firms; adapting to requirements for counter-trade and other

forms of compensatory trade in dealing with developing countries and state trading countries; re-examining the role of trading corporations, including in project management; promoting acceptance of Canadian standards abroad and mutual recognition of testing and certifying capability; developing regional export marketing strategies in cooperation with the provinces; maintaining close liaison and consultation with provincial governments in ongoing export development activities; and examining possible overlaps between federal and provincial export development programmes.

Major challenges facing export marketing efforts will be to ensure that support services respond to the needs of small and medium-sized firms and that programme delivery services (e.g., PEMD) are decentralized to the extent possible. Considerably more effort is needed to assist Canadian companies to take advantage of new markets opened by GATT Agreements such as those related to government procurement, and technical barriers to trade. In addition, Canadian access to foreign technologies and knowledge either in the form of commercial licensing arrangements or industrial and technological cooperation, will become of increasing importance.

b) *Providing Competitive Financing*

The whole question of export credits will be of considerable importance, particularly for advanced-technology products and capital equipment. Officially supported export credits have become a major competitive factor in the international marketplace, but, unless this practice is better contained, it may result in ruinous competition among national treasuries. There is no way that Canada can win in an outright competition with the treasuries of the USA or France.

Canada is participating actively in international discussions to contain the subsidy element in export financing and to improve the current consensus arrangement in the OECD. Until such international order can be restored, Canada's limited fiscal capacity to provide export credit subsidies must be carefully directed towards export opportunities which have long-term developmental potential for Canadian industry. In addition, there is room to increase the participation of private financial institutions in export trade financing, as well as a greater integration of private banks with EDC financing facilities. EDC financing facilities must be made as accessible as possible to small and medium-sized businesses. Canada's limited fiscal resources can also be stretched by encouraging joint financing of projects abroad with the export financing facilities of other countries sharing in the exports.

c) *Developing Trade through Aid*

An easily forgotten aspect of the federal government's trade promotion programmes is the more than one billion dollars of aid channelled annually through the Canadian International Development Agency. While the link between aid and trade is indirect, it is nonetheless real and Canadians should so regard it. Providing aid merely to advance the fortunes of particular Canadian exporters would be to misconstrue the purpose of aid. It would be equally unfortunate to give out aid in a form that denies the prospect of creating future markets for Canadian goods and services. This means that Canada should not foist aid on developing countries in the form of

goods and services that are Canadian but not competitive on commercial markets (which would be an abuse of tied aid), but rather use aid as a pump primer for competitive Canadian goods and services.

The Canadian business community has long sought greater integration of the government's aid and trade policies. While there are limits to what can be achieved without denying the essentially humanitarian and developmental nature of aid, much more can be done to forge new and growing commercial relationships through official development assistance. In the longer run, the developmental aid provided by CIDA should help to create new and viable trading partners for Canadian exporters in new parts of the world.

Conclusions:

- Federal and provincial export development assistance programmes to help Canadian business exploit export opportunities are not substitutes for competitiveness. We need to be selective, to coordinate our efforts, and to concentrate our limited resources and leverage on those sectors and markets where Canada has genuine strengths and opportunities. Small- and medium-sized firms in particular need easy access to export development and assistance programmes through a more decentralized delivery. The development of regional export strategies should be geared to aiding small and medium-sized exporters.
- Export financing is an increasingly determinant instrument in the highly competitive international marketplace. This will require a strong presence by the commercial banks. Canada must remain competitive but continue to seek a tighter international discipline intended to reduce the subsidy element of export credits.
- Canada's aid programme provides a strong, long-term investment aimed at building future markets in developing countries.

VII. **The International Institutional and Trading Environment:** A Fragile Consensus

Trade flows, of course, on a bilateral basis and the management of trade relations is on a government to government basis. The multilateral trading system, however, provides the framework through which we pursue our interests and opportunities bilaterally. The keystone for Canadian trade policy over the past three decades has thus been the maintenance of an open, multilateral and non-discriminatory trading system as embodied in the GATT and supported by other major multilateral bodies, particularly the IMF and the OECD. Canadian involvement in, and support of, these institutions responds to a basic Canadian perception of its place in the world economy and how it can best achieve its commercial bilateral objectives without unreasonably and unacceptably impinging upon national sovereignty. Through these multilateral arrangements governing the international trade and payments system,

Canada has been able to influence the policies and practices of the major economic powers and to minimize the risks and costs of direct confrontation. To the extent that these institutions work effectively, they provide safety valves for tension and decrease the temptation of major economic powers to settle problems among themselves to the detriment of smaller powers. Equally, it is important in this context that we work to sustain a strong US commitment to the multilateral trading system, thereby reducing the risk that the major trading entities will develop bilateral solutions which do not adequately reflect Canadian interests.

The post-war multilateral institutions were, of course, designed for an international environment quite different from the one we face today. The question, therefore, is whether they can be adapted to meet the environment of the 1980s. There have been pronounced shifts in industrial power away from the USA and towards Europe, Japan and some developing countries, although the US role in international trade remains dominant. Developing countries present potential market growth areas, reflecting their increasing demographic weight, and also represent a major source of competition for raw materials as well as for an increasing range of low-cost and standard-technology products. OPEC power in the petroleum and money markets has also significantly contributed to substantially different competitive relationships in areas such as petrochemicals. Similarly, many state-trading countries have sought to have their interests accommodated within the multilateral trade and payments system.

Together with the GATT, the IMF and IBRD have been the pillars of the post-war trade and payments system. It was recognized from the outset that all the problems in international trade cannot be addressed with trade measures alone. Some of these must be addressed with macro-economic and monetary policies within the ambit of the IMF. This fact is borne out today by the problems generated for the trading system by the increasing debt-burden of developing and state-trading countries and the volatility of financial markets. The continued integrity of the system will thus require that the IMF also adapt to changing circumstances by being provided with increased resources and flexible operating procedures. As an open economy crucially dependent on both foreign trade and financial flows, Canada has a major stake in the health of the international monetary system. Canada will thus continue to promote and support measures which enhance the further development of the system in ways which maintain an international climate favourable to non-inflationary growth and expansion in trade and financial flows. The system should promote global and non-discriminatory objectives which are aimed at serving the interests of the world economy as a whole. Changes in the system must thus be viable and durable and consistent with these objectives.

Put simply, the multilateral system is based on the economic theory of comparative advantage and the belief that the competitive forces at work in international trade, and the effective operation of the price mechanism, are beneficial and should be strengthened. It also reflects the importance attached to stability, order and predictability provided by the rule of law for the conduct of international trade relations. Essentially, Canada has seen the multilateral system embodied in the GATT and IMF as the most effective means of safeguarding and enhancing Canadian trade objectives vis-à-vis major trading entities such as the United States, Europe and

Japan. More specifically, the multilateral trade negotiating process has enabled Canada to increase its leverage by combining with those holding similar objectives on particular issues while maintaining flexibility to stand with other countries when interests differ. Participation in the multilateral system has also enabled Canada to balance the interests of different regions of the country in a way that enhances the cohesiveness of the Canadian common market. It has also made it possible to share the benefits of trade agreements negotiated between other trading partners as well as to reduce the risk of Canada's being singled out for special treatment by other entities when it comes to instituting restrictive trade measures.

While the GATT has provided an effective and dynamic framework for the pursuit of Canadian interests, there is concern in Canada and elsewhere about its relevance and capacity to deal adequately with current problems and pressures on the trading system. There are doubts that major trading entities are prepared to resolve their problems within the GATT framework and questions whether it provides an adequate basis to contain and manage the proliferation of preferential trading arrangements and non-tariff measures adversely affecting trade, production and investment. While there may be doubts about its adequacy, the existence of the GATT has mitigated a 'rule of the jungle' in international trade and the domination of crude power relationships to resolve disputes. The fundamental fact of life is that the GATT can only be as effective as its major participants are prepared to make it. In the end, the will to exercise fully GATT rights and accept obligations will be important in strengthening the credibility of the system. A major issue for the 1980s will be whether the GATT can be adapted to meet this challenge. In the absence of a GATT-like trade instrument, Canada would be left to deal with the big powers one on one.

Although regional trading blocs proliferated in the 1950s and 1960s to an extent not originally anticipated, the GATT rules provide for the formation of such arrangements. Canada was instrumental in having such provisions in the GATT when it was originally negotiated. For geopolitical reasons unrelated to trade, the USA was prepared to accept the formation of the EC as a reasonable price for European integration, even though some aspects of the EC adversely affected its trade interests (particularly agricultural policies). In effect the formation of the EC and its later enlargement to include the United Kingdom, were accompanied by international trade negotiations to maintain the balance of negotiated trade interests between Canada and Europe and to bring down the level of the Common External Tariff.

Given Canada's large stake in trade, Canada must in the first place seek to preserve and enhance the multilateral trading system, in fair weather or in foul. This is not a matter of choice, but one of practical necessity—nor does it inhibit our ability to strengthen bilateral relationships with key trading partners. On the contrary, the two objectives are complementary and mutually reinforcing. At the same time it must be recognized that regional trading blocs are more important than they were a generation ago. While Canada is not formally a member of a regional bloc, at a practical level we are to all intents and purposes part of a North American regional market and thus partner with a very significant player indeed. There is no other way to read the various links that have been forged over the years with the USA. (The

pros and cons of further integrating Canada into a North American trading bloc are discussed below). Yet it does not detract from the imperative of continuing to strengthen ties with others and ensuring that the EC and other regional blocs do not establish protectionist practices which discriminate against non-members.

The principal concern of the trading system in the immediate post-war years was the reduction of tariffs, and much has been achieved through seven rounds of negotiations. Tariffs are now at their lowest historical level and in most cases can no longer be considered a major impediment to international trade. In the 1960s and 1970s concern increasingly focussed on non-tariff barriers. Again, through the GATT, trading nations have begun to tackle the need to bring many non-tariff measures within a firm framework of international rules and subject them to international scrutiny. In both cases, Canada benefited from the progressive development of an open, multilateral trading system despite fears that the Canadian economy was not strong enough to withstand full international competition. Attention in the 1980s is likely to focus increasingly on the need for the freer flow of investment and for discipline on subsidies and other incentives with trade-distorting effects.

Attention is now focussed internationally on both unfinished business arising from earlier rounds of trade negotiations and on new challenges facing the trading system. The GATT Ministerial meeting in November, 1982 provided an important opportunity for the Contracting Parties to address these problems and to chart a constructive work programme. This programme should not only strengthen the conviction on all sides that an ordered and disciplined system for trade serves the interests of all countries, rather than imposing impediments or constraints, but should also condition much of Canada's trade policy formulation in the decade ahead. The GATT agenda offers opportunities for Canada to pursue a number of important interests, including:

- a continued search for improvements in the safeguards system, including bringing under multilateral discipline those safeguard measures taken outside the GATT (e.g., the so-called voluntary export arrangements and orderly marketing arrangements);
- a further strengthening of the dispute settlement procedures which could serve to mitigate further the power disparities between Canada and its major trading partners;
- an expansion of the Government Procurement Agreement to include sectors such as telecommunications, power generation and transmission, and surface transportation equipment;
- an expansion of the product coverage of the Civil Aircraft Agreement and measures to deal with concessional export financing practices in this sector;
- a possible review of the Subsidies and Countervailing Duties Agreement to contain, for example, the use of concessional export financing as a commercial policy instrument generally;
- a continued search for improvements in international rules governing agricultural trade, particularly those relating to direct and indirect export assistance;

- an opportunity to lay the ground for further improving foreign market access for resource-based products, particularly fisheries, nonferrous metals and forest products;
- the gradual acceptance by the more advanced developing countries of international obligations commensurate with their pace of economic development; and
- the possibility of introducing an international framework for trade in services;

Other issues likely to be addressed over the decade include:

- the introduction of an international system of tariff nomenclature and related commodity classification which take account of Canada's particular needs;
- consideration of the practices of MNEs in the context of trade-related investment issues; and,
- examination of the particular problems that may exist in trade in advanced-technology products.

Commodity trade remains a significant component of Canadian exports and imports and commodity trade issues will continue to require careful attention. Given the continued volatility in prices, trade flows and export earnings in trade in primary resources, there continues to be pressure for special arrangements to cover this trade, both generally and on a commodity-specific basis. Canada has been supportive of many initiatives aimed at stabilizing commodity prices, although cautious about the various techniques which may be used to achieve this objective. On the whole, Canada believes the market should be the primary vehicle for inducing appropriate changes in supply and demand, supplemented when appropriate by various arrangements based on intergovernmental cooperation. While these arrangements are complementary to and supportive of broader GATT arrangements, they are usually pursued separately and strongly influenced by North-South considerations. Given Canada's primary interest as a commodity exporter (as compared to most industrialized countries who see their interests primarily as commodity importers), we are particularly vulnerable to discussions which display a developmental bias. Because of the unique characteristics associated with each commodity and the diversity of Canadian commodity trade interests, it will continue to be in Canada's interest to approach international consideration on a flexible case-by-case basis involving both producers and consumers. Furthermore, there is a need to be particularly careful of the possible adverse affects on Canada of initiatives to help overcome LDC debt problems on the basis of shortfalls in expected commodity export earnings.

Conclusions:

- The multilateral trade and payments system has served Canada well. It provides an effective means for Canada further to improve access to world markets, to promote economic stability and predictability based on the rule of law, and to manage trade relations with larger countries. The progressive development and strengthening of the system over the next decade could open up new opportunities. It is difficult to envisage an effective alternative to bet-

ter serve Canadian interests. The multilateral trading system is currently experiencing severe strains, most clearly manifested in protectionist pressures. The system is still fundamentally healthy, but these pressures challenge governments to manage the system positively and constructively.

- The multilateral system has proven an effective means to manage trade relations with larger trading partners and an important objective of trade policy will be to retain US, EC, and Japanese commitment to the system.
- Over the next decade it will remain important to strengthen the system, building on the results of the GATT Ministerial and efforts in the IMF to equip it with improved resources to provide the necessary stability to the monetary system.

VIII. Managing Our Trading Relationships

Growing interdependence between states has meant that the realization of domestic priorities and objectives for many countries is becoming more and more closely related to constraints and opportunities flowing from the international economic environment. It has become a fact of economic life that the decisions and actions of one country increasingly affect those of others. As a result, the economic component of foreign policy has been enhanced, and the management of trade relations will tend increasingly to be dominated by the interrelationship between foreign and domestic policies, both as the international environment influences domestic policies and as domestic interests have to be reflected in foreign policy objectives and priorities.

Those countries which have been most successful in dealing with the complexities of an interdependent world have demonstrated a capacity to define their national interests clearly and to bring a large measure of coordination to their domestic and foreign policies. This has required a clear sense of direction and an understanding of where and by what means their interests should be pursued. It has also required the development of priorities in the use of scarce financial and human resources and, in terms of bilateral relationships, an understanding of which countries are most important to their interests. It requires a long-term and coherent approach to the cultivation of bilateral relationships. One of the challenges will be to develop forms of bilateral cooperation which do not lessen the role and importance of multilateral frameworks on which Canada is so dependent. Indeed, it should prove possible to strengthen multilateral cooperation through bilateral ties—since these are different facets of the same basic relationships in an increasingly interdependent world.

Foreign policy is the end product of an integration and balancing of the range of Canadian interests after the international environment in which these interests are pursued has been taken into account. In this balancing process, given the realities of the 1980s, particular weight will need to be given to those elements of foreign policy which support the goal of economic growth. Expansion of trade, increased efficiency through trade, and in particular the growth of Canadian exports is basic to economic growth and the achievement of a whole range of national objectives. It is important

that Canada's foreign policy develop close relationships with those countries which are most important to Canada's economic development and which offer the best opportunities for long-term markets for Canadian exports. Building the appropriate frameworks for cooperation with these countries will require the deployment of a variety of foreign policy instruments in support of the goal of economic growth. At the same time, it must be recognized that Canada can not pursue a one-dimensional foreign policy and that from time to time serious security and other considerations may assert their own primacy.

In forging closer and more productive links, close attention will need to be paid to those elements which define the quality of the relationship—which ensure a multi-dimensional approach. Economic ties will wither on the vine unless supported by a carefully cultivated commonality of interests, by continuity in the relationship, and by an earned reputation for reliability and steadfastness. Canada's involvement in the annual Economic Summits of industrialized countries must be seen in this context. These provide an opportunity, at the highest political level, for commitments on trade issues and other international economic topics contributing to the avoidance of the beggar-thy-neighbour protectionist policies of the 1930s. These do not denigrate the solid achievements of the GATT and IMF but underlines that these contractual ties are not enough.

In the conduct of trade relations with its main trading partners, particularly with the USA, the federal government has sought to maximize Canada's negotiating leverage while preserving Canada's sovereignty. Trade with the USA, Japan and the EC accounts for 85 percent of Canada's total trade. Although the USA and the EC represent relatively slow-growth markets, and the economies of selected developing countries are growing more rapidly, this overall pattern is unlikely to change dramatically in the next decade. The newly industrialized developing countries still represent relatively small markets and their need for the goods Canada produces cheaply and abundantly is limited. Their real potential is longer term. The trading relationships with the USA, Japan and the EC are largely assymetrical in that they are more important to Canada than Canada is for these key trading partners. In 1981, the USA took 66 percent of our exports, the EC 11 percent and Japan 5 percent, but Canadian exports represented only 18 percent of US imports and 2 percent and 2.5 percent of EC and Japanese imports respectively. In terms of Canadian imports, 69 percent came from the USA, 10 percent from the EC and 5 percent from Japan; the Canadian market, however, represented only 17 percent of total US exports, 2 percent of EC and 2.5 percent of Japanese exports.

a) *The United States: Our Main Trading Partner*

The United States is, and will remain, Canada's biggest customer and largest supplier. Whatever the pace of growth of that market and whether or not Canada's share of that market increases or decreases, relations with the United States will remain crucial to Canada's well-being. The objectives and principles which govern the conduct of that relationship are thus of the utmost importance.

Of late, the relationship has been dominated by a sense of malaise on both sides of the border, fuelled by the unusually deep recession and the differing

approaches of the two governments to the role of government in the economy. Relations have recently been characterized by a high degree of public diplomacy—which matches Canadian determination to chart our own course against US frustration about the declining role of the USA in world economic affairs. Canadians, more comfortable with the more relaxed relations of the past, are wondering what we should be doing to again bring harmony to Canada-US relations. Many Canadians, particularly in the business community, consider that the government, in formulating and presenting policies (e.g., FIRA and the NEP) which respond to a broadly shared desire to gain greater control over the Canadian economy, has not been sufficiently sensitive to all considerations, including US interests, and to the risks to US retaliation against Canadian interests in the US market. This concern has been sharpened by the protectionist mood in Congress, and by our continued vulnerability to changes in US economic fortunes. It is important, therefore, that in future particular attention be paid in devising and presenting national policies to ensure that US interests and sensitives are adequately addressed and US policy-makers appreciate the reasons for these policies.

The management of the Canada-US relationship, of course, deals with more than bilateral irritants. Billions of dollars of trade flows without any problems being brought to the attention of either government. There are also matters of mutual advantage. There is the possibility, for example, of further expanding our cross-border trade, either on a general or a sectoral basis or in the context of working out solutions to specific problems. Greater emphasis will undoubtedly have to be placed on identifying such areas and encouraging the business community to follow up the opportunities provided. Such activity will confirm that we are interested in managing our relationship in a positive sense rather than dealing with one another only where irritants arise. The same applies to the multilateral side. Since the war, we have shared the same interest in strengthening the international trading system and are continuing to work together toward many of the same objectives. There are other areas where we have been similarly affected by the policies of others and have cooperated in seeking appropriate solutions. Finally, issues are continually resolved to each others satisfaction, such as the cross-border trucking issue.

In its report of March, 1982 on *Canada's Trade Relations with the United States*, the Senate Standing Committee on Foreign Affairs suggested that our economic development would be advanced through the conclusion of a comprehensive and preferential free-trade agreement between the two countries. This idea has been raised on a number of occasions in the past, most notably in the US Trade Agreements Act of 1979 which required the President to report to Congress by August, 1981, on the possibility of such agreements with countries of the "northern portion of the Western Hemisphere". The President's report did not make any recommendations as to how this might be pursued nor did it suggest that such an agreement was either desirable or imminent at this stage. For a number of reasons, the proposal poses even more difficulty for Canada, at least in the foreseeable future. The fact that it has been put forward on both sides of the border, however, implies a recognition that the two countries share many interests and that there remain opportunities for cooperation to be explored. Furthermore, it denotes an interest on both sides of the border to emphasize more positive elements and opportunities in the relationship.

The reasons adduced by various proponents of the free trade option include the following:

- Much of Canadian manufacturing industry is not competitive internationally, having developed behind a protective tariff. Greater efficiency can be achieved through rationalization but the domestic market alone is too small to allow for such rationalization and the realization of available economies of scale.
- The United States is Canada's natural market for manufactured goods (as well as for many resources and agricultural items). Free trade between Canada and the United States would provide a large enough market and a necessary competitive stimulus for Canadian industry; it could thus induce greater efficiency, higher earnings and living standards for Canadians.
- The dislocation costs of free trade would be reduced by phasing in tariff reductions over an extended period. It may not be necessary to include agricultural items in a free trade arrangement. The floating exchange rate would tend to cushion the adverse short-term impact of free trade on the Canadian manufacturing sector and to reduce the risk of a major bilateral balance of payments deficit for Canada.

Opponents of bilateral free trade would, on the other hand, argue that adjustment costs would outweigh any short-term advantages and that the longer term gains for Canada predicted by international trade theory would not be realized in a Canada-US context for the following reasons:

- Canadian manufacturing industries enjoy few comparative advantages vis-à-vis the United States. Consequently, the removal of tariffs would simply lead to the replacement over time of Canadian manufacturing production by American. Canadian labour (and other factors) released from manufacturing would be drawn into the resources and services sector, would seek to emigrate or, most probably, would swell the ranks of the unemployed.
- Heavy US ownership in Canadian industry would, through the operation of "board room prejudices", tend to result in Canadian production being relocated in the United States even in those instances where Canadian production costs were lower.
- The exchange rate cannot be counted on as a regulator of relative competitiveness and location advantages between Canada and United States in the manufacturing sector. There are simply too many influences on the exchange rate.
- The structure of the Canadian economy following free trade would be less conducive to the future development of Canada. A strengthening of the resource sector at the expense of manufacturing might yield higher income but would stultify efforts to foster the indigenous technology and R & D capability necessary for Canada's longer term success as an industrial society.

Many Canadians, including a number of those who would accept the validity of the economic case for free trade, would reject a Canada-US free trade agreement on the grounds that the process of managing the North American economy would

lead inevitably to the formation of common institutions; given relative economic weight, the United States would tend to dominate these institutions; and, Canada's political sovereignty would, over time, be eroded. Proponents of bilateral free trade would note that the Canadian economy is already closely integrated with that of the United States and that inter-dependence is likely to increase in future whether or not governments seek to modify the institutional and legal aspects of the bilateral trading environment. The Canadian economy will, they argue, become increasingly more vulnerable to US policies and that arrangements to reduce the dangers of changes in such policies to Canadian exports would be to Canada's advantage.

A decision to negotiate a free-trade arrangement with the United States would constitute a major political undertaking by any Canadian government. Such a decision would obviously require the federal government's taking into consideration the views of all elements of Canadian society, including the provincial governments. An important political step of this type would evidently have to be based on a sound assessment of the economic and political impact of free trade on the Canadian economy. The economic issues which would need to be examined in this context would include:

- productivity in and competitivness of the Canadian manufacturing, resource, and agricultural industries;
- the effects of free trade (involving removal of tariffs and, where appropriate, NTBs) on prices, costs, employment, investment location and industrial structure;
- the consistency of free trade with Canada's economic objectives and programmes (e.g., government support for R&D, regional development and the extent to which free trade would necessitate the harmonization of Canadian and US policies and laws in such matters as regional development, taxation, competition, and industrial incentives);
- the consistency of any free-trade arrangement with trade policy objectives in offshore markets;
- US goals and objectives and the desirability and practicability of including Mexico in any free trade association with the United States;
- the status of agriculture in any free trade arrangement;
- institutional implications of free trade for Canada including the need for joint agencies to manage the association;
- the need for and nature of safeguard provisions; and
- the "security" of any free-trade arrangement in terms of the US legislative process; the risks of Congressionally initiated amendments or abrogation.

The free-trade option has been a contentious issue throughout Canada's history, due less to economic considerations than to issues of sovereignty and self-determination. The evidence to date of the need to proceed is not convincing, nor does a call for free trade command broad support. Most assessments tend to highlight the economic advantages for Canada without taking full account of the costs or consequences, both political and economic. It remains, however, an option which may garner broader support at some point in the future if changed circumstances lead to dif-

ferent attitudes. Many of the arguments favouring freer trade may be satisfied, however, by entering, gradually, into bilateral agreements to resolve particular issues of the type presented by US restrictions of Canadian sales of urban mass transit equipment and US tariffs on Canadian exports of petro-chemicals. Free trade with the United States on such a limited, sectoral basis would not raise the more difficult issues posed by the full free-trade option and would be consistent with the gradual movement by successive Canadian governments towards free trade. Proceeding on such a basis need not necessarily be limited to Canada and the United States, but could include other interested countries.

Sectoral free trade is not a new idea (e.g., the Auto Pact in the North American context; the Aircraft Agreement multilaterally), and the expansion of this concept may offer the most promising prospects for expanding Canada-US trade and for improving the economic base of a number of Canadian industries. In a number of sectors (e.g., textiles, urban transportation, petrochemicals) there is significant scope for furthering the rationalization within North America on which the private sector has already embarked but which is now inhibited by trade barriers on both sides of the border. An exploration of the possibilities for limited, sectoral free trade should thus identify ways and means to promote reciprocal trade expansion, to increase the efficiency of national industrial structures and to enhance regional economic prospects. It may also prove one way of meeting the shared problem of how to meet the competition from third countries and to slow down the exodus of production facilities from North America. A full examination needs, of course, to take careful account of the views of the private sector and the provinces, as well as an assessment of likely US reaction.

Because we rely heavily on the US market for our economic well-being and because there are vast intra-corporate links, there is great sensitivity about any policies or practices which threaten the existing pattern. Yet, there are pulls in the opposite direction, and they are not related solely to sovereignty. Because we deal so heavily with the USA, our companies are inclined instinctively to look south first and *not* to look elsewhere. Thus the ease and familiarity of doing business in North America can become a liability preventing efforts to exploit prospects elsewhere. If the US market is indeed shrinking, this could become a real threat in the future. For that reason, efforts which emphasize market diversification will continue to command serious attention.

The two approaches are not mutually incompatible but rather represent two different emphases in a continuum stretching from continental integration to deliberate differentiation. The attraction of greater cooperation is that it recognizes the realities of geography and economics. The respective private sectors are already largely integrated; trade runs more easily north-south than east-west; and the US market is not greatly different from the Canadian market. Yet continentalism runs counter to the drift of Canadian history—from the National Policy to the Third Option, Canada has evolved as a separate and different nation because its people wanted to be Canadians and wanted to build on traditional ties with Europe and our window on the Pacific. Thus there will always be tension between economic and political realities and ideals. That tension is what challenges the conduct of Canada-US relations in the 1980s—as it has in every decade in Canada's history.

Factors which will condition Canada-US trade in the first half of the 1980s include:

- the relationship with the USA is basic to building up relationships with others. If we are seriously at odds with the USA, it will be difficult to build with others;
- the implementation of the Tokyo Round results through to 1987 and the need to monitor full implementation and assist Canadian business to take full advantage of them;
- the preponderance of Canadian exports will be entering the USA duty-free, meeting a long-standing need of Canadian industry for free access to a large market; however, for certain resource-based products and a range of high-technology goods the US tariff remains a significant barrier to increasing Canadian exports; some of these barriers can be addressed through sectoral free-trade arrangements;
- the existence of extensive non-tariff measures agreements provides a framework to deal with problems arising from the implementation of the US system of contingency protection;
- shared goals and objectives of strengthening the open multilateral trade and payments system, will add to the ability to resolve bilateral problems;
- any advantages reached through further GATT negotiations (e.g., on Government Procurement, the Aircraft Agreement) will have the greatest dividends in the context of trade with the United States;
- effective management of Canada-US trade relations, particularly the impact of various policy decisions on each others' interests (e.g., investment and extra-territoriality), will be crucial to Canadian trade objectives;
- the competitive challenges facing the automotive industries in both the USA and Canada will continue to be a centre-piece in the bilateral relationship, and the future of Canadian industry will remain closely tied to developments internationally; and
- Canada-US trade will continue to enjoy the advantages of *inter alia* similar business practices, transportation, and corporate connections; and the relative importance of Canada-US trade (65-70 percent throughout the 1970s) is unlikely to change in the 1980s.

The task of managing the relationship smoothly is, of course, made more complex as the more aggressive pursuit by the USA of its interests clashes with the interests of its trading partners. Canada, for its part, has been and will continue to be preoccupied with regional and industrial development and with questions of foreign investment/ownership. The effect will be that ownership policies, subsidies, regional development programmes, investment incentives, duty remissions, offsets, export financing, and other trade-related measures will be factors in Canada-US trade relations, as will similar programmes and policies in the USA. More than ever, in an interdependent world, Canadian policies will need to be framed against the background of the likely foreign, particularly US, reaction.

Management of the relationship will also need increasingly to take serious account of priorities. The traffic will bear only so much at any given time, nor are we equipped to conduct all that many operations at the same time. There are, at any given time, many issues outstanding between us. Some of these issues are of demonstrably greater consequence for Canada's economic interests than others. While it is true that we are not bargaining with the United States across a single table, the players are often the same. At the very least, a sensible strategy will ensure that the lesser issue does not adversely affect the more important. As often as not, this may be a matter of timing rather than substance—but there is no alternative to prudent traffic control.

b) *The European Community: Building on Traditional Ties*

The EC represents one of Canada's largest markets for agricultural goods and a number of other resource-based products. The traditional ties with Europe and the existing contractual arrangements with the European Community provide a strong basis for deepening and diversifying the relationship, and working cooperatively in areas of common interest, both in multilateral fora and in pursuing export opportunities in third markets. The general terms of access for Canada in Europe in the next decade will remain difficult, but there is some prospect for improving our access to EC markets for resource and downstream products by building upon the EC's interest in Canadian resources, including energy. This will need to be balanced by efforts to reduce the trade distorting effects of the Common Agricultural Policy and to improve market access for Canadian agriculture and fishery products. This is a clear example of the need for careful management of the relationship between our trade and investment interests. There is also scope offered by opportunities for technological and industrial co-operation in, for example, aircraft and energy. More effort is needed to develop a more sophisticated economic relationship with key member states and to promote greater awareness of the opportunities for expanded trade and of the potential emerging from the results of the Tokyo Round and other negotiations.

c) *Japan: The Challenge of Diversification*

Trade relations with Japan depend largely on the complementarity between a resource-rich supplier and a resource-poor industrial giant. This relationship has generally produced a trade surplus for Canada; there is scope, however, for development and diversification of the relationship, and for improvements in the value-added component of Canadian exports. In addition, there remain fundamental questions which need to be addressed in the decade ahead. There is concern about the extent to which we should use our leverage, e.g., on resources, to secure better access for manufactured exports and more job-creating investment. There is need to build on what has been achieved and to encourage more investment partnership, joint ventures etc.

There is a strong concern in Canada that our market is more open to Japanese producers than Japan's market is for Canadians. This stems from continuing Japanese barriers on resource-based manufactured goods as well as sheer Japanese competitiveness. This is compounded by the difficulties of penetrating the Japanese

system. Thus a basic trade policy objective for Canada and others vis-à-vis Japan will be to urge greater and real trade liberalization efforts by the Japanese authorities. Equally, we need to ensure that Japanese moves to counter such pressures from the EC and the USA create equal opportunities for access by Canada. Growing Congressional frustration with the imbalance in US-Japan trade suggest that US pressure is likely to mount in the near term. Japanese skill and success at economic planning and in pursuit of economic objectives call for a clear and disciplined response on the Canadian side. Patience, perseverance and singleness of purpose will be vital to success and will help offset the assymetrical nature of the relationship. They are essential to the further development of market opportunities for a range of Canadian goods and services. Specifically there is a need for aggressive and persistent marketing support for Canadian business, to take advantage of Japan's industrial restructuring; to place greater emphasis on the high technology sector, and to encourage greater diversification of the economic relationship involving investments, joint ventures, etc.

d) *Developing Countries: Toward More Mature Relationships*

In the years ahead, the markets of developing countries will provide increasingly significant export opportunities for Canadian agriculture and fishery products, capital equipment and a range of advanced-technology products, although access conditions remain uncertain. Canada's economic and political interests are advanced through the creation of multi-faceted relationships with dynamic partners in Asia (e.g., China, Korea, ASEAN), Latin America (e.g., Brazil, Venezuela, Mexico) and the Middle East (e.g., Saudi Arabia, Algeria). The government can continue to create a favourable environment and competitive support for trade with these countries through high-level visits, promotional efforts, and assistance programmes, but the initiative to take advantage of the potential rests with the private sector. These countries will continue to be major suppliers of tropical foodstuffs, and some industrial materials such as bauxite. They will also pose competitive challenges for Canadian producers of labour-intensive and standard-technology goods, as well as for raw materials in third countries. Because of the similarity of the Canadian and LDC economies, however, LDC trade will remain of less direct significance to Canada for some years to come than it is to the USA, EC, and Japan, both in terms of exports and imports. A further factor limiting the short-term potential of these markets is the heavy debt burden many are carrying, extending to the point where some are seeking loans to pay off debt charges. Nevertheless, some LDC markets will offer promising outlets for capital goods and high-technology products.

The development of a more mature relationship will include attention to:

- continued efforts in concert with other countries both to accommodate the economic development needs of developing countries through expanded exports and to seek a greater degree of acceptance of international trade obligations by the newly-industrialized countries;
- active expansion of commercial relationships with the more industrialized developing countries and exploitation of export opportunities for Canadian agriculture, fisheries, advanced-technology products, capital equipment and related engineering and consulting services;

- coordinated efforts with developing countries in economic development projects in these countries through aid, commercial exports of goods and services, investment and joint ventures; and
- continued willingness to join international commodity stabilization agreements (e.g., tin, sugar, coffee, etc.) which are remunerative to producers and fair to consumers.

e) *Other Countries: Maintaining Productive Ties*

Trade relations with other countries such as Australia, New Zealand, the countries of EFTA, and state-trading countries will continue to make a major contribution to the well-being of individual producers and regions, especially for fully manufactured products. Access to these countries' market is reasonably good and in many cases is conditioned by both participation in the GATT and bilateral arrangements. While the volume of trade is unlikely to grow significantly, the opportunities for expansion of exports of particular product lines is significant. For the state-trading economies, exploitation of opportunities through countertrade may prove more rewarding than traditional trade flows, requiring a more than normal element of government participation. The Soviet Union has long been a major importer of Canadian grains, and together with other Eastern European countries, has potential as a market for Canadian manufactured goods. Though opportunities are conditioned by East-West political realities and financial constraints, there remains adequate scope to develop broad, stable and sophisticated trading ties with the centrally planned economies.

Conclusions:

- The relative share of Canadian trade with the USA, the EC, and Japan will probably continue to represent about 85 percent of the total for the foreseeable future.
- As the US share (roughly two-thirds of the total) will remain predominant, the management of Canada-US trade relations can determine the success or failure of most of our economic policies, as well as our relations with most other countries. The future direction of Canada-US relations must therefore be a matter of first priority.
- Trade with the EC and Japan is likely to continue to be dominated by resource-based exports and imports of manufactured goods and equipment, but there is a need to improve the product mix of our exports to both and to gain increased access to these markets.
- The existence of an effective framework of multilateral rules to deal with non-tariff measures and resolve disputes, the range of existing bilateral arrangements, and the extent of duty-free access to the US market already achieved, provide scope for closer economic cooperation with the USA.
- The risks of our trading partners' systems of contingency import protection being misused for protectionist purposes are real. However, international

rules reduce the risk of arbitrary recourse to such measures and provide the instruments necessary to deal with problems. Appropriate and timely exercise of Canada's GATT rights can be effective in preserving market access for Canadian exports to these markets.

- Developing countries pose a series of challenges: as markets for agricultural and fishery products, capital investment and advanced-technology goods; as suppliers of highly competitive standard-technology products, tropical foodstuffs and industrial raw materials; and as partners in the multilateral trade and payments system. Maintenance of preferential access for developing country exports serve as a useful mechanism to encourage LDC economic development and to strengthen economic ties between Canada and the LDCs.

IX. **Domestic Consultative Framework:** Building a National Consensus

The combined impact of both domestic and international policies, including the relationship of federal and provincial policies, affect the ability of Canadian business to exploit its competitive advantage. A major challenge of policy management in the 1980s will thus be to ensure proper coordination of these various policies. The recent government re-organization is designed to strengthen the capacity of the federal government to respond positively and effectively to this challenge.

In the formulation and implementation of Canada's trade policy and the conduct of trade relations, consultations with various private interests have normally been held on specific issues as circumstances warrant. As well there are structured, ongoing consultations involving bilateral and sectoral business groups, such as the Export Trade Development Board, the Canada-Japan Business Committee and the Canadian Business and Industry International Advisory Council. During the Tokyo Round, the Canadian Trade and Tariffs Committee, which was established to hold consultations with various interests concerned, received approximately 500 individual submissions. This consultative process was furthered by confidential discussions with different interests by the Canadian Coordinator for Trade Negotiations. These consultations, of course, focussed on negotiating objectives and not on trade-offs and tactics. Consultations with the private sector were prominently featured in the preparation of this Discussion Paper. Throughout the 1980s consultation with private sector interest groups will remain a key ingredient necessary to develop broadly based and coherent domestic and international priorities.

There has been a steady evolution in the structure for federal-provincial consultations or exchanges of views on international trade and commercial policy matters. One of the direct effects of the gradual shift from the almost exclusive focus on traditional border instruments, to concerns with the impact of domestic economic policies and programmes on international trade, has been the need to increase and intensify consultations with the provinces. It is recognized that the prospects for expanding trade offer dividends of a regional as well as sectoral nature and that success in establishing improved access can help resolve internal tensions. At the same time, the provinces have become increasingly concerned with the impact of international trade developments on their policies and economic development prospects.

Major examples where federal and provincial policies bear on international trade and trade agreements are in the areas of government procurement, government subsidy and support programmes and regulations on product standards.

The Tokyo Round experience of consultation with the provinces helped to improve the awareness and sensitivity of the federal government to provincial priorities and concerns and demonstrated to Canadian business and our trading partners that there can be effective federal-provincial consultations in striving to enhance market access conditions for Canadian exporters and thus improving Canada's trade performance. In the run-up to the GATT Ministerial meeting in November there were again frequent federal-provincial discussions which were instrumental in preparing Canadian positions. Through regular contact at the Ministerial and Deputy-Ministerial levels (the first Federal-Provincial Meeting of Trade Ministers was held in June, 1982) and through federal-provincial committees, a more structured framework for consultations on international trade matters now exists, including the Federal-Provincial Committees on Trade Relations and on Export Development at the senior officials' level. These now play a useful role in the effective management of Canada's trading interests, and will contribute to greater coordination and harmony between federal and provincial programmes and activities.

One of the most important challenges of this ongoing consultative process in the 1980s will be to ensure that Canada's trade leverage internationally is not undermined or dissipated by conflicting domestic interests, policies or programmes. Equally, predatory trading practices by foreign governments that may otherwise be tempted to play-off one set of internal interests against another must be countered by a common and more coherent federal-provincial approach. Similarly, because Canada's international competitiveness depends significantly on its ability to maximize the economies of scale offered by its own integrated domestic market, and because its negotiating trade leverage is considerably influenced by the attraction of its entire domestic market to foreign suppliers of goods and services, this consultative framework should contribute to a better understanding of the importance of ensuring an effectively functioning common domestic market. There is clearly room for a stronger national consensus on the need for a free flow of goods and services internally and for the prevention of the balkanization of the Canadian market.

Conclusions:

- Canada's trade performance would be enhanced by a stronger national consensus on the need for, and the benefits to be derived from, a freer flow of goods and services internally.
- A consensus on trade and economic goals would be enhanced by regular and open consultations with the provinces and with private sector interest groups.
- Canadians, both in government and outside, need increasingly to demonstrate Canada's reliability as a competitive and stable producer of advanced-technology as well as resource products.